Disclosure Report in accordance with § 26a of the German Banking Act and the German Solvency Regulation

as at 31 December 2013

Finanzgruppe

NORD/LB

Die norddeutsche Art.

The rounding of figures may result in minor differences in the totals and percentages calculated in this report.

1 PREAMBLE

This disclosure report is based on the German Solvency Regulation, which specifies the capital adequacy of banks, banking groups and financial holding groups set out at § 10 German Banking Act.

The German Solvency Regulation (Solvabilitätsverordnung (Solv)) transposes the European standards prescribed in the Banking Directive and the Capital Adequacy Directive into national law. The European standards in turn are based on the international Basel II set of regulations issued by the Basel Committee on Banking Supervision.

Requirements relating to the regular disclosure of qualitative and quantitative information to enhance market discipline are defined in Pillar 3 of Basel II. The aim was to create transparency with regard to the risks entered into by the banks. Pillar 3 thus supplemented the minimum capital requirements of Pillar 1 and the supervisory review process of Pillar 2. In Germany the disclosure requirements were generally implemented in § 26a of the German Banking Act. These requirements were specified in Part 5 of the German Solvency Regulation in §§ 319 to 337.

The above paragraphs represent the basis for the disclosure for the last time. In the scope of the CRD IV/CRR regulatory reform package, the associated requirements have shifted to the European level. From 2014 onwards the directly applicable EU CRR (capital requirements regulation) shall apply.

This report as at 31 December 2013 constitutes the disclosure of qualitative and quantitative information in accordance with the German Solvency Regulation by Norddeutsche Landesbank Girozentrale, Hanover, (NORD/LB) as the superordinate institute in the NORD/LB Group for the regulatory basis of consolidation. Disclosure in accordance with the German Solvency Regulation is generally aligned towards a group approach. This means that member companies in the Group are not obliged to disclose such information separately.

The disclosure principles and the disclosure process of the NORD/LB Group are set out in the “Disclosure Guidelines for the Norddeutsche Landesbank group on Regulatory Disclosure in accordance with § 26a German Banking Act and the German Solvency Regulation”. An important principle in this respect is the regular review of the disclosure report with regard to the need for optimisation. As a result of the last review several optimisations have been carried out to further improve transparency. Where only clarifications or more precise definitions were made, these are considered in this report, but they are not explicitly pointed out as they did not result in any changes in content. A key constant change was the approval of the use of the retail IRBA for NORD/LB, which resulted in adaptations to different parts of the report as well as in particular the adoption of Table 12 at section 5.1.4.3 Credit Volumes and Losses in the IRBA Portfolio.

The disclosure report is an auxiliary document supplementing the Annual Report of the NORD/LB Group prepared on the basis of International Financial Reporting Standards (IFRS) and the individual annual reports of group member institutes prepared on the basis of the German Commercial Code (HGB). Norddeutsche Landesbank Luxembourg S.A., Luxembourg, and NORD/LB COVERED FINANCE BANK S.A., Luxembourg are exceptions in this case since the bank prepares its annual financial statements in accordance with IFRS.

Information on equity is disclosed on the one hand, while on the other hand material risks and the corresponding system of risk management as well as methods of risk control are described. The overall risk profile of the NORD/LB Group was reviewed and its material risks identified in the risk inventory. This currently includes credit risk, investment risk, market-price risk, liquidity risk and operational risk.

Quantitative disclosures contained in this report are based on the German Commercial Code (Handelsgesetzbuch (HGB)) which currently constitutes the basis for preparing regulatory reports in accordance with the German Solvency Regulation in the NORD/LB Group. Norddeutsche Landesbank Luxembourg S.A. and NORD/LB COVERED FINANCE BANK S.A. are exceptions here too, since their quantitative disclosures are based on Lux GAAP for the disclosures on equity or on IFRS.

For further information about risk beyond regulatory German Solvency Regulation requirements, this report contains a few references to the forecast, risk and opportunity report which is part of the NORD/LB Group's management report. Here a detailed account is given on risk developments for each significant type of risk in the period under review and an outlook for developments anticipated in future.

In accordance with § 320 para. 1 of the German Solvency Regulation, this disclosure report is published in the Investor Relations/Reports section of the NORD/LB website. Publication of the report was announced in the electronic German Federal Register (www.ebundesanzeiger.de) in accordance with § 320 Paragraph 2 of the German Solvency Regulation.

2 APPLICATION

German Solvency Regulation requirements for disclosure relate to regulatory groups of institutes in accordance with § 10a of the German Banking Act. However, only the significant companies from a risk point of view in the group of institutes are included in disclosure. The institutes are selected on the basis of a materiality concept which is reviewed and adapted regularly and as required to guarantee that changes in the regulatory basis of consolidation are properly taken into account for disclosure purposes.

Compliance with the principle of materiality therefore results in a different scope of application. The group of significant companies, which is included in the quantitative risk reporting using the look-through approach, is defined in a multi-stage process which is described in section 5.2.1. In the NORD/LB Group, quantitative risk reporting on the basis of individual risks is based on the significant group companies from a risk point of view.

Based on this concept, NORD/LB, Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –, Bremen (Bremer Landesbank), Norddeutsche Landesbank Luxembourg S.A., Luxembourg (NORD/LB Luxembourg), Deutsche Hypothekenbank (Actien-Gesellschaft), Hanover (Deutsche Hypo) and NORD/LB COVERED FINANCE BANK S.A., Luxembourg (NORD/LB CFB), are included in this report as significant group institutes from a risk point of view. All qualitative and quantitative disclosures therefore refer to this basis of consolidation. Special features of individual group companies are stated explicitly.

From the point of view of the entire group, the other institutes account in quantitative terms for an insignificant level of individual risk. Risks concerning these companies are treated as investment risk.

The audit of the significant group companies from a risk point of view considers both the consolidated companies in accordance with IFRS and the companies included in the regulatory basis of consolidation. "Group" is thus the term used below to refer to both the regulatory group and the Group in accordance with IFRS.

In accordance with § 323 para. 1 no. 2 of the German Solvency Regulation, Table 1 contains an overview of the regulatory group of significant institutes included in the NORD/LB Group and information on how they are treated in the IFRS basis of consolidation.

Table 1: Consolidation matrix for the NORD/LB Group

Type of institute	Name	Regulatory treatment				IFRS consolidation	
		Consolidation		Deduction method	Risk-weighted investments		
		Full	Proportionate			Full	Measured using equity method
Bank (parent company)	Norddeutsche Landesbank Girozentrale	●				●	
Bank	Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –	●				●	
Bank	Norddeutsche Landesbank Luxembourg S.A.	●				●	
Bank	Deutsche Hypothekenbank (Actien-Gesellschaft)	●				●	
Bank	NORD/LB COVERED FINANCE BANK S.A.	●				●	

The independent market presence of the five significant group institutes highlights the focus on their own products and regions while, at the same time, the close ties within the group represent a significant factor for success. Below is a description of each institute.

NORD/LB is a registered public institute in Germany, with registered offices in Hanover, Braunschweig and Magdeburg. Its head office is in Hanover. NORD/LB is the state bank (Landesbank) for the federal states of Lower Saxony and Saxony-Anhalt. In these two federal states and in Mecklenburg-Western Pomerania the Bank performs the functions of a central and clearing bank for the savings banks (Girozentrale). NORD/LB operates in the segments of Private and Commercial Customers, Corporate Customers & Markets, Energy and Infrastructure Customers, Shipping and Aircraft Customers and Real Estate Banking Customers.

Bremer Landesbank sees itself as a universal bank acting as a regional commercial bank with specialist international business while at the same time performing its role as a state bank and a central bank for the savings banks. Its core business region is North West Germany, from where the bank supports its regional and international customers in Europe. The owners of Bremer Landesbank are NORD/LB, which holds 54.8 per cent of the share capital, the federal state of Bremen with a 41.2 per cent shareholding and the Association of the Savings Banks of Lower Saxony with 4.0 per cent.

NORD/LB Luxembourg was founded in 1972 as an independent public limited enterprise under Luxembourg law. Since 1975 the bank has been a full subsidiary of NORD/LB. NORD/LB Luxembourg's activities lie in the business segments of Private Banking, Corporate Banking and Financial Markets.

Deutsche Hypo, which was established in 1872, is a mortgage bank with a rising volume of commercial real estate business. The pooling of know-how raises the significance, image and acquisition power of the NORD/LB Group among customers, partners and investors in the market for providing finance for commercial real estate. NORD/LB holds all the share capital and the voting rights of Deutsche Hypo.

NORD/LB CFB was established as a full subsidiary of NORD/LB Luxembourg. It is a specialised bank with a licence to issue lettres de gage publiques (covered bonds in Luxembourg law). NORD/LB CFB acts as a centre of competence for the NORD/LB Group's OECD-wide international public finance business. NORD/LB CFB's issues concentrate on medium and long-term covered issues outside the EURO.

In addition to the five significant institutes in the NORD/LB Group stated above, the basis of consolidation under regulatory law comprises another 47 companies which are not significant from a risk point of view and in which NORD/LB holds direct or indirect interest. This includes 38 financial companies, four financial services institutes, four providers of ancillary services and a capital investment company. This does not include the companies subject to the deduction method.

In terms of regulatory law, ten of these companies are fully consolidated and one is partially consolidated. 36 companies are exempted from inclusion in the Group report pursuant to § 31 (3) German Banking Act (Kreditwesengesetz (KWG)).

In the basis of consolidation under commercial law, 50 subsidiaries are included alongside the parent company NORD/LB after full consolidation. One joint venture and ten affiliated companies are accounted for using the equity method.

A complete list of equity holdings in accordance with § 313 para. 2 of the German Commercial Code is published in the notes to the consolidated financial statements (Note 83).

The insignificant Group companies from a risk point of view result in differences between the figures in the disclosure report and those in the Annual Report of the NORD/LB Group. Differences may also occur because German Commercial Code figures are used in the disclosure report and IFRS figures in the consolidated financial statements and because other effects of consolidation are not included.

In the NORD/LB Group there are currently no limitations or other significant restrictions on the transfer of funds or liable equity in accordance with § 323 para. 1 no. 3 of the German Solvency Regulation.

The Managing Boards of NORD/LB and Deutsche Hypo decided on 30 June 2013 to announce the use of the waiver option by Deutsche Hypo in accordance with § 2a (1) in the version of the German Banking Act applicable at this time. The profit / loss transfer agreement concluded for an indefinite period of time by Deutsche Hypo and NORD/LB constitutes the basic prerequisite for this. At the individual institute level of Deutsche Hypo, following the announcement of the regulatory banking regulations concerning capital adequacy requirements at institute level, the requirements concerning the reporting of large exposures, the calculation and ensuring of risk-bearing capacity, the formulation of strategies and the establishment of processes to identify, assess, control, monitor and communicate risks no longer apply. The aforementioned requirements are, against the background of the regulatory management of Deutsche Hypo by NORD/LB, transferred to NORD/LB as the parent company.

As part of the realignment of the sub-group NORD/LB Luxembourg, in 2012 all of the market and back-office activities of NORD/LB CFB were integrated into NORD/LB Luxembourg. With the approval of the CSSF (Commission de Surveillance du Secteur Financier) as Luxembourg's financial Supervision authority, NORD/LB CFB's business activities are conducted by NORD/LB Luxembourg's market divisions. It is also fully integrated into the risk control of NORD/LB Luxembourg, which for its part is responsible for the implementation of the relevant risk control mechanisms in both companies. Capital adequacy is consequently reported on in a report for the NORD/LB Luxembourg Group.

Further utilisation of exception provisions relating to the fulfilment of individual requirements under the German Banking Act relating to subsidiary group member institutes as defined as a waiver provision do not exist at NORD/LB.

As at the reporting date no subsidiaries pursuant to § 323 (2) German Solvency Regulation existed in the NORD/LB Group that are subject to the deduction method and report insufficient capital.

3 RISK MANAGEMENT

3.1 Risk Management Strategies and Processes

The business activities of a bank inevitably involve the conscious undertaking of risks. Efficient risk management in terms of a risk-and-return-oriented allocation of equity is therefore a key component of modern bank management and a high priority for the NORD/LB Group. Risk management is primarily based on the controlling of risks. From a business point of view, the NORD/LB Group defines risk as being potential direct or indirect financial losses due to unexpected negative differences between the actual income and projected income of business activity.

The NORD/LB Group conducts at least once a year and when required a multi-stage process to develop an overall risk profile in accordance with the Minimum Requirements for Risk Management (MaRisk) AT 2.2 and AT 4.5. The overall risk profile comprises the risk types relevant for the NORD/LB Group. Material in this context are all relevant risk types which could have a negative impact on the NORD/LB Group's capital resources, earnings, the liquidity position or the achievement of NORD/LB Group's strategic goals.

Basic conditions for structuring this risk management process are specified for banks and groups of banks in the MaRisk on the basis of § 25a of the German Banking Act. In accordance with these requirements, proper business organisation includes the specification of strategies on the basis of procedures for ascertaining and securing risk-bearing capacity, which comprises both risks and the capital available for covering these risks.

The responsible handling of risks is the uppermost priority in the business policy of the NORD/LB Group. The group risk strategy, drafted with this in mind, overrides the risk strategies of the significant group companies from a risk point of view. With regard to the organisation of risk management and the risk sub-strategies, the group risk strategy is substantiated in the risk strategies of the significant companies from a risk point of view taking into account the respective business models.

The risk strategies of the significant group companies from a risk point of view are in each case defined in accordance with the business model, the business strategy and the group risk strategy policy and are reviewed at least once a year and as and when required. All risk strategies contain information on the principles of risk strategy, the organisation of the risk management and on sub-strategies for risks relating to the material risk types.

The core element of the risk strategy is the risk-bearing capacity model (RBC model), on the basis of which risk appetite is specified. For the NORD/LB Group it was conservatively determined that normally in a going-concern scenario as the primary control group at most 80 per cent of the risk capital may be covered with risk potential. 20 per cent of the risk capital is held as a buffer.

The maximum risk capital is also allocated to the material risk types in the risk strategies on the basis of the RBC model. Most of the cover pool is allocated to credit risks, reflecting the NORD/LB Group's focus on customer-oriented lending business. The individual institutes are responsible for determining the allocation relevant for them, although this must be consistent with the allocation for the group.

The group risk strategy and the risk strategies of the significant companies from a risk point of view were reviewed and adjusted in 2013 and discussed with the Supervisory Board after being passed by the Managing Board.

The risk strategies aim to achieve an optimal management of all material risk types and to achieve the transparent presentation of these risks to the management, the supervisory bodies and other third parties with a justified interest. Based on this, the significant group companies from a risk point of view have a range of further instruments at operational level which ensure that there is sufficient transparency of the risk situation and structure the required limitation and portfolio diversification in a way which can be controlled and monitored. These instruments are described in detail in the NORD/LB Group's risk handbook and in the risk handbooks and relevant documents of the individual companies.

Furthermore, the NORD/LB Group has also made commitments in the reorganisation plan agreed with the EU which are considered in the risk management.

Pursuant to MaRisk AT 4.5 the NORD/LB Group has installed an appropriate and effective risk management process. The structures guarantee the regulated interaction of all the divisions of the significant group companies from a risk point of view involved in the risk management process. Furthermore, procedural precautions with clearly defined tasks and authorities ensure smooth and efficient procedures – backed up by an adequate IT infrastructure and qualified employees. An effective internal control and monitoring system ensures compliance. The aim is to consistently optimise the risk organisation and to adapt it to current requirements.

The NORD/LB Group has implemented risk management processes which cover all divisions. The sub-processes apply to all risk types:

- Risk identification: Identification of the relevant risks (overall risk profile) in the risk inventory based on the risk universe and distinction between material and non-material risks (reviewed at least annually and via event-related reviews)

- Risk assessment: Regular quantitative and / or qualitative assessment of risks using predefined methods

- Risk reporting: Reporting on the risk situation (internal and external, risk-type specific and general, regular and ad-hoc)

- Risk control and monitoring: Limitation and management (acceptance, mitigation, transfer, avoidance) of risks and monitoring of limits (limit / utilisation comparison)

Activities for the ongoing optimisation of the risk organisation include improvement to the internal control system geared to establishing uniform process and risk-oriented structures and procedures. Detailed descriptions of the risk management sub-processes are laid out in the NORD/LB Group's risk handbook and the relevant documents of the individual institutes.

For more detailed information on risk management strategies and processes in accordance with § 322 of the German Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.2 Risk Management Structure and Organisation

Responsibility for the NORD/LB Group's risk management lies with the Managing Board of NORD/LB. The Managing Board coordinates the group risk strategy and its amendments in the Erweiterter Konzernvorstand (Extended Group Managing Board), which also includes the Chairmen of the Bremer Landesbank, NORD/LB Luxembourg and Deutsche Hypo. NORD/LB CFB, as a subsidiary of NORD/LB Luxembourg, is represented by NORD/LB Luxembourg in the Erweiterter Konzernvorstand. After the group risk strategy has been passed by the Managing Board of NORD/LB, it is submitted to the Supervisory Board of NORD/LB for its information and discussed with it.

The responsible Chief Risk Officer (CRO) in the Managing Board of NORD/LB bears, in concert with the heads of the market departments, responsibility for drawing up and monitoring the group risk strategy. This includes the monitoring of material risks including the risk reporting at group level. At individual institute level responsibility lies with the respective Managing Board or the risk officer.

NORD/LB's Finance and Risk Control Division is responsible for updating and developing the RBC model, continually monitoring compliance and regularly reviewing the risk strategies of the NORD/LB Group and NORD/LB.

Operational risk management is performed decentrally in the group companies. In order to ensure the greatest possible comparability with regard to the assessment, monitoring, controlling and reporting of all material risks, the instruments used for this purpose are agreed with the significant institutes from risk point of view.

In addition to the Erweiterter Konzernvorstand, various other committees are involved in the risk management of the NORD/LB Group:

- Konzernsteuerungskreise (Group Control Committees): A system of Konzernsteuerungskreise (KSK), whose members are, depending on the Konzernsteuerungskreis, various members of the Managing Board and divisional heads of the significant companies from a risk point of view, supports the institute-wide control.

- Group Risk Committee: The Group Risk Committee (GRC) is chaired by the Chief Risk Officer. Other permanent members are the director responsible for Special Financing and Corporate Customers, the director responsible for Financial Markets, the heads of the Central Management Risk, the Finance and Risk Control Division, Research / Economy and the credit back office divisions of NORD/LB and the risk officers at Bremer Landesbank, NORD/LB Luxembourg and Deutsche Hypo. Further participants are invited when required. The GRC supports the respective Managing Board in the holistic consideration of risks. The focus of the GRC lies in considering the overall portfolio of the NORD/LB Group taking into account all material risk types and strengthening group integration.

- RWA(+) Board: The RWA(+) Board is responsible for generating impetus in the operational control of risk-weighted assets (RWA). In addition to the Head of the Finance and Risk Control Division and the representatives of the market divisions of NORD/LB, among others the representatives of the Credit Risk Management Division, Finance Division and the significant subsidiaries from a risk point of view have voting rights. In this committee the relevant information on RWA and shortfall development and on economic and regulatory equity is analysed and combined in a forecast. In the RWA(+) Board possible measures are compiled, assessed and controlled in respect of their implementation.

- Other advising committees: The Konzernsteuerungskreise and Managing Boards are supported by a number of other committees which provide advice in specific areas. These include for example the Asset Liability Committee (ALCO).

The structure and organisation of risk management at the NORD/LB Group meets the MaRisk. The process of risk management is subject to constant review and improvement. Adjustments which may be made cover organisational measures, adjustments to procedures for quantifying risk and the continuous updating of relevant parameters.

The risk-oriented and process-independent audit of the effectiveness and adequacy of risk management is carried out by the Internal Audit Divisions of NORD/LB and the subsidiaries. As an instrument of the Managing Board, they are part of the internal monitoring process. The aims of Internal Audit also include the monitoring of the effectiveness, the efficiency and correctness of business activities. It also facilitates the optimisation of business processes and of controlling and monitoring procedures.

The Group audit is carried out in addition to the internal audits in the subsidiaries. The focus is on the consistency of the subsidiaries' business and risk strategies with the business and risk strategy of the NORD/LB Group, group-wide risk-bearing capacity, structures, procedures, risk management processes and risk control processes within the scope of group-wide risk management, Group reporting, Group accounting, finance and risk reporting to the Konzernvorstand and the effectiveness of the subsidiaries' Internal Audit departments. The scope, objectives, tasks and instruments of the Group audit are defined in the Group Audit Policy.

The treatment of new products, new markets, new sales channels, new services and their variations is regulated decentrally in the new product process (NPP) in the significant individual institutes of the NORD/LB Group from a risk point of view taking into account the respective conditions. There is close coordination between the institutes regarding the implementation of NPP.

The essential aim of NPP is to identify, analyse and assess all potential risks for the NORD/LB Group prior to starting the new business. This includes all of the essential audit areas, documentation of the new business activities, their treatment in the overall operational process, the decisions to start the business and where applicable the associated restrictions.

For more detailed information on the structure and organisation of risk management in accordance with § 322 of the German Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.3 Hedging and Mitigating Risk

Various measures for hedging and mitigating risk are undertaken, depending on the type of risk in question. For more detailed information on hedging and mitigating risk in the system of risk management in accordance with § 322 of the German Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.4 Risk Reporting

The Finance and Risk Compass prepared on a quarterly basis and the preliminary summary of the risk situation of NORD/LB Group and the risk-bearing capacity reports (RBC reports) prepared in the subsidiaries on at least a quarterly basis constitute the key instrument for the internal reporting of risks at group and individual institute level to the respective Managing Board and the supervisory bodies. Compliance with the determinations of the risk strategies on risk appetite and on the allocation of risk capital to the material risk types is therefore reviewed regularly.

In addition to receiving the report on risk-bearing capacity, the Managing Boards of the institutes subject to the Covered Bond Act (Pfandbriefgesetz) are also informed about risks relating to Pfandbrief business on at least a quarterly basis. These reports prepared at individual institute level meet the requirements of § 27 of the Covered Bond Act.

In general the management approach is applied for risk reporting: internal and external risk reports are always based on the same terms, methods and data.

In addition to risk reporting for the entire bank, data relating to the individual risk types is regularly reported to the Managing Board and to bodies, committees and specialised bank divisions. For details on reporting within the scope of risk management in accordance with § 322 of the German Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.5 Risk Types

3.5.1 Credit Risk

Credit risk is a component of counterparty risk and is broken down into traditional credit risk and counterparty risk in trading. Traditional credit risk defines the risk of loss involved when a credit borrower defaults or when the credit rating of such a credit borrower deteriorates. Counterparty risk in trading defines the risk of loss involved when a borrower or contract partner in trading transactions defaults or when the credit rating of such a borrower or contract partner deteriorates. It is broken down into default risk in trading, replacement risk, settlement risk and issuer risk:

- Default risk in trading defines the risk of loss involved when a borrower defaults or when the credit rating of such a borrower deteriorates. It equates to traditional credit risk and relates to money market transactions.

- Replacement risk defines the risk of the contract partner in a pending transaction with a positive present value defaulting and this transaction having to be replaced with a loss.

- Settlement risk is broken down into advance payment risk and clearing risk. Advance payment risk defines the risk when the bank has completed a payment of the counter-payment not being made by the contract partner or, if payments are offset, the balance not being paid. Clearing risk defines the risk of transactions not being able to be cleared by either party upon or after the expiry of the contractually agreed performance date.

- Issuer risk defines the risk of loss involved when an issuer or reference entity defaults or when the credit rating of such an issuer or reference entity deteriorates.

In addition to the original credit risk, cross-border capital transfer services involve country risk (transfer risk). This is the risk that, despite the ability and willingness of the individual counterparty to meet payment claims, a loss will occur as a result of overriding government hindrances.

3.5.2 Investment Risk

Investment risk is another component of counterparty risk and defines the risk of incurring losses when making equity available to third parties. A potential loss due to other financial obligations is also a component of investment risk, unless it was considered in the other risks.

In addition to the original investment risk, cross-border capital transfer services involve country risk (transfer risk).

3.5.3 Market-Price Risk

Market-price risk is defined as the potential losses which may be incurred as a result of changes in market parameters. With market-price risk a distinction is made between interest-rate risk, currency risk, share-price risk, fund-price risk, volatility risk, credit spread risk in the banking book and commodity risk.

- Interest-rate risk always occurs when the value of an item or a portfolio reacts to changes to one or several interest rates or to changes in full yield curves and when these changes may consequently impair the item. This also includes the credit spread risk in the trading portfolio and the liquidity reserve in accordance with the German Commercial Code.

- Credit spread risk in the banking book defines potential changes in value which would result in the banking book if the credit spread applicable for the respective issuer, borrower or reference entity used for the market value of the item changed.

- Other partial risks relevant for NORD/LB include the risk that the value of an item reacts to changes in one or more currency exchange rates (currency risk), share prices or share indexes (share-price risk), fund prices (fund-price risk) or volatilities applied for valuing options (volatility risk) and the changes result in a reduction in the items value.

3.5.4 Liquidity Risk

Liquidity risks are risks which may result from disruptions in the liquidity of individual market segments, unexpected events in lending, investment or new issue business or deterioration in the Bank’s own refinancing conditions. The NORD/LB Group understands placement risk to be a component of liquidity risk. It describes the risk of own issues not being placed in the market or only placed at poorer conditions. Liquidity risks are broken down into traditional liquidity risk, refinancing risk and market-liquidity risk:

- Traditional liquidity risk is the risk that payment obligations cannot be met or cannot be met on time. Potential causes can be a general disruption in the liquidity of money markets which affects individual institutes or the entire financial market. Market disruptions may in particular result in significant asset classes not being available for use as collateral. Alternatively, unexpected events in lending, investment or new issue business may also result in liquidity shortages. The focus of the NORD/LB Group consideration is on the respective coming twelve months.

- Refinancing risk constitutes potential declines in earnings resulting from the worsening of the banks own refinancing conditions on the money market or capital market. The most significant cause in this case is a change in the assessment of the bank's credit rating by other market participants. The focus of consideration here is on the entire range of terms to maturity. By considering the individual currencies, spread risks from cross-currency swaps will also be considered.

- Market-liquidity risk defines the potential losses to be borne if transactions need to be concluded at conditions which are not in line with the fair market value due to a lack of liquidity in individual market segments. Market liquidity risks may primarily result from security items in the trading and banking books.

3.5.5 Operational Risk

Operational risks are possible and from the viewpoint of NORD/LB Group unintended events which occur as a result of the inadequacy or failure of internal procedures, employees and technology or as a result of external events and result in a loss or have a very negative consequence for the NORD/LB Group (e. g. infringement of the law). Legal risks are included, strategic risks and business risks are not.

In accordance with this definition, legal risks, risks due to a change in law, compliance risks, outsourcing risks, dilution risks, fraud risks and vulnerabilities in contingency and crisis management are included in operational risks.

- Legal risk defines the risk of losses occurring due to the non- or insufficient consideration of the legal framework specified by legal regulations and case law. The risk of a change in law is the risk of a loss due to new laws or regulations, a disadvantageous change to existing laws or regulations or their interpretation or implementation by the courts. Legal risk only exists in the Bank's external relations.

- Compliance risk defines the risks of penalties being handed out by courts, authorities or disciplinary bodies as a result of improper procedures, processes and the like (due to non-compliance with laws, regulations, codes of conduct and standards) in the Bank's internal relations.

- Outsourcing risk defines the risks resulting from the outsourcing of activities and processes.

- Dilution risk defines the risk relating to the balance and convertibility of a purchased receivable as a result of the borrower of the purchased receivable not being obliged to pay in full.

- Fraud risk defines the risk resulting from other criminal actions against the bank which cause a preventable loss of assets or damage to reputation.

4 CAPITAL STRUCTURE AND ADEQUACY

4.1 Capital Structure

The components of capital of the NORD/LB Group included in the summary in accordance with § 10a (6) of the German Banking Act comprise the core capital and the supplementary capital allocated to the consolidated companies (companies that belong to the group) as well as certain deductions.

The core capital of the NORD/LB Group as at 31 December 2013 before half-deductible items totals € 9,261 million and primarily comprises capital paid in, other eligible reserves, a special item for general banking risks in accordance with § 340g of the German Commercial Code, additional capital in accordance with § 10 para. 2a clause 1 no. 8 of the German Banking Act, other capital in accordance with § 10 para. 2a clause 1 no. 10 of the German Banking Act and asset-side differences of which 50 per cent may be recognised.

The capital paid in totalling € 1,656 million comprises the share capital of NORD/LB as the superordinate company (€ 1,607 million) and shares in the share capital or capital stock of subordinate companies (€ 49 million).

Other eligible reserves total € 5,387 million and comprise capital reserves and retained earnings. In 2013 these reserves increased by € 32 million, particularly due to retained earnings.

The special item for general banking risks in accordance with § 340g of the German Commercial Code in the amount of € 1,497 million serves to reinforce the capital of the NORD/LB Group.

Additional capital in accordance with §10 para. 2a clause 1 no. 8 of the German Banking Act totalling € 10 million and other capital in accordance with §10 para. 2a clause 1 no. 10 of the German Banking Act totalling € 813 million consists entirely of contributions from silent partners. Since 31 December 2010 the inclusion as core capital is based on the regulations in accordance with §10 paras. 2, 2a and 4 of the German Banking Act in conjunction with the transitional regulations in accordance with § 64m of the German Banking Act. Accordingly, contributions from silent partners received before 31 December 2010 are depending on the drafting of contracts either included as additional capital or other capital. Additional capital is to be included 100 per cent as core capital. Other capital may in accordance with § 10 para. 2 clause 4 of the German Banking Act make up at most 35 per cent of the core capital for solvency purposes.

Other capital which has a fixed term or involves a repayment incentive for the issuer due to the contractual arrangements may, in deviation to this, make up at most 15 per cent of the core capital for solvency purposes in accordance with § 10 para. 2 clause 3 of the German Banking Act. However, all contributions from silent partners received before 31 December 2010 may, on a transitional basis and in accordance with § 64m para. 1 of the German Banking Act,

- be included until the end of 2020 in full as core capital;
- be neither additional nor other capital, and between 2021 and 2030 not make up more than 20 per cent and between 2031 and 2040 not make up more than 10 per cent of core capital for solvency purposes.

These regulations of the German Banking Act, however, will no longer have any practical effect as the version of the German Banking Act applicable to 31 December 2013 inclusive will be superseded by the EU Capital Adequacy Directive (EU-CRR) as regards regulations for the inclusion of capital instruments as equity from 1 January 2014.

The contributions from silent partners existing as at 31 December 2013 have varying contractual arrangements and are to be categorised for inclusion in core capital as follows:

- An indefinite contribution without any cancellation privilege on the part of the subscribers and with the same status as share capital, which does not involve a repayment incentive for the issuer (in total € 10 million), issued in 2011. The interest for this contribution is for the first few years fixed at the capital market yield on the date of issue plus a standard market risk premium, after which it varies on an annual basis in the amount of the respective capital market yield plus a standard market risk premium which is fixed on the date of issue. Interest payments are excluded under certain conditions and are at the sole discretion of the issuer. This contribution meets the requirements of additional capital in accordance with § 10 para. 2a clause 1 no. 8 of the German Banking Act in conjunction with § 10 para. 4 of the German Banking Act.

- Indefinite contributions without any cancellation privilege on the part of the subscribers with priority to share capital which do not involve a repayment incentive for the issuer (in total € 401 million), issued since 2005. As compared with year end 2012, the volume of regulatory eligible contributions has fallen by € 167 million as part of the contributions was restructured during the reporting year, or the legal framework conditions of a contribution changed during 2013 such that these contributions no longer fully satisfy the stipulations under § 10 German Banking Act relating to the eligibility of equity. The interest for all of these existing contributions is either fixed at the capital market yield on the date of issue plus a standard market risk premium or it is only fixed for the first few years of the term as already described, after which it varies on an annual basis and amounts to the respective capital market yield plus a standard market risk premium which is fixed on the date of issue. Interest payments are excluded under certain conditions. All of these contributions meet the requirements of other capital in accordance with § 10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with § 10 para. 4 of the German Banking Act.

- Indefinite contributions without any cancellation privilege on the part of the subscribers which contractually involve a repayment incentive for the issuer (€ 363 million), issued in 2009. In 2013 the regulatory eligible volume rose by a total of € 26 million as the contribution is nominally $ 500 million and the amount allowable in Euro has changed accordingly due to the development of the EUR / USD exchange rate. The interest for this contribution is fixed for at least the first ten years of the contract in the amount of the capital market yield at the time of issue plus a standard market risk premium. After this time, and then every further five years of the contract, the interest is reset at the level fixed in the contract at the time of issue. Interest payments are excluded under certain conditions. This contribution meets the requirements of other capital in accordance with § 10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with § 10 para. 4 of the German Banking Act, but falls due to the repayment incentive resulting from the fixed level of interest in the contract below the above-mentioned upper limit for inclusion in accordance with § 10 para. 2 clause 3 of the German Banking Act of at most 15 per cent of core capital for solvency purposes. The NORD/LB Group complies with this upper limit as at 31 December 2013.

- Indefinite contributions with a cancellation privilege on the part of the subscribers (in total € 50 million), issued in 2001. These contributions may be cancelled by the subscribers or by the issuer. The interest for all of these existing contributions is adjusted after ten years of the contract to the current capital market yield plus a standard market risk premium which is fixed on the date of issue. Interest payments are excluded under certain conditions. These contributions do not fully meet the requirements of other capital in accordance with § 10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with § 10 para. 4 of the German Banking Act and are therefore only included as other capital in the core capital on a transitional basis in accordance with § 64m para. 1 of the German Banking Act.

Contributions from silent partners eligible for inclusion as other capital make up as at 31 December 2013 10 per cent of core capital for solvency purposes. The NORD/LB Group therefore complies with the above-mentioned upper limit for inclusion in accordance with § 10 para. 2 clause 4 of the German Banking Act of 35 per cent for other capital in core capital for solvency purposes.

Other core capital components include asset-side differences resulting for all the regulatory investments which are fully or proportionately consolidated and whose carrying amount in the superordinate company exceeds the total of that investment's share capital and reserves. Half of these asset-side differences (altogether approx. € 9 million) are included as core capital.

For regulatory measurement purposes, half of the deductions shown below are deducted from the core capital (a total of € 1,150 million). The resulting core capital for solvency purposes totalled € 8,112 million as at 31 December 2013.

The NORD/LB Group's supplementary capital as at 31 December 2013 totalled € 2,849 million before half-deductible items and primarily comprised the following components:

- Provision reserves according to § 340f of the German Commercial Code (total of € 12 million).

- Participatory capital liabilities (totalling € 60 million), which have an original term to maturity of at least ten years. The amount of interest is calculated as the capital market yield on the date of issue or prolongation plus a standard market risk premium. The requirements for inclusion in supplementary capital in accordance with § 10 para. 5 of the German Banking Act have been met.

- Subordinated liabilities (totalling € 2,786 million) with original terms to maturity primarily of ten years or more. In the period under review subordinated liabilities totalling € 300 million were issued. The amount of interest for all subordinated liabilities is calculated as the capital market yield on the date of issue or prolongation plus a standard market risk premium. The requirements for inclusion in supplementary capital in accordance with § 10 para. 5a of the German Banking Act have been met.

- The half of asset-side differences to be deducted (totalling € 9 million). The asset-side differences indicated above, half of which are recognised as core capital, are in turn deducted from supplementary capital.

Furthermore, for regulatory measurement purposes, half of the deductions shown below are deducted from the supplementary capital (a total of € 1,150 million). The supplementary capital for solvency reasons calculated in this way totals € 1,700 million as at 31 December 2013.

The deductions from core capital and supplementary capital amounted to € 2,299 million as at 31 December 2013 and comprise

- the carrying amounts of investments in accordance with § 10 para. 6 clause 1 nos. 1 and 5 of the German Banking Act

- receivables from subordinated liabilities in accordance with § 10 para. 5 of the German Banking Act and

- deficits in valuation allowances in accordance with § 10 para. 6a no. 1 of the German Banking Act.

Compared to the end of 2012, deductions have increased by a total of € 481 million, in particular due to an increase in deficits in valuation allowances.

For regulatory measurement purposes, half of the total of these deductions is deducted from core capital and half is deducted from supplementary capital.

Table 2 shows the components of capital in the regulatory capital structure in accordance with § 324 para. 2 of the German Solvency Regulation.

Table 2: Capital structure

(in € million)	31 Dec. 2013	31 Dec. 2012
Share capital paid in	1 666	1 676
of which: Contributed capital	1 656	1 666
of which: Additional capital in accordance with § 10 para. 2a clause 1 no. 8 of the German Banking Act	10	10
Other eligible reserves	5 387	5 356
Other capital in accordance with § 10 para. 2a clause 1 No. 10 German Banking Act in acc. with § 10 para. 4 of the German Banking Act	813	954
of which: Other capital, convertible in a debit situation	–	–
of which: Other capital, indefinite and without repayment incentives	401	568
of which: Other capital, temporary or with repayment incentives	363	336
of which: Temporarily eligible core capital instruments subject to a transitional regulation, indefinite and without repayment incentives	50	50
of which: Temporarily eligible core capital instruments subject to a transitional regulation, temporary or with repayment incentives	–	–
Special item for general banking risks in accordance with § 340g of the German Commercial Code	1 497	1 466
Asset-side differences	9	10
Other deductions in accordance with § 10 para. 2a clause 2 of the German Banking Act	– 111	– 102
Total core capital in accordance with § 10 para. 2a of the German Banking Act	**9 261**	**9 360**
Total supplementary capital in accordance with § 10 para. 2b of the German Banking Act and tier three funds in accordance with § 10 para. 2c of the German Banking Act	**2 849**	**3 234**
Total capital deductions in accordance with § 10 paras. 6 and 6a of the German Banking Act	**– 2 299**	**– 1 818**
of which: Deficits in valuation allowances and anticipated loss amounts for IRBA items in accordance with § 10 para. 6a nos. 1 and 2 of the German Banking Act	– 2 057	– 1 565
Total modified available equity in accordance with § 10 para. 1d of the German Banking Act and eligible tier three funds in accordance with § 10 para. 2c of the German Banking Act	**9 811**	**10 776**

4.2 Capital Adequacy

4.2.1 Approaches for Determining Capital Requirements

4.2.1.1 Credit Risks

In order to calculate equity capital required for credit risks, the NORD/LB Group essentially uses the Internal Ratings Based Approach (IRBA).

Promotional institutes, the subsidiary Skandifinanz Bank AG, insurers, the Bremer Landesbank's commercial foreign real estate finance and Deutsche Hypo's and Bremer Landesbank's retail banking are excluded for an indefinite period from the IRBA. Exposures excluded from the IRBA for an indefinite period are shown in the Credit Risk Standardised Approach (CRSA).

The exposure class of retail was transferred to the IRBA on 30 November 2013. For the segment of minor customers without a current account partial use is still applied. Transfer to IRBA is scheduled for 2014.

Exposures for which no internal rating procedure is available due to a gap in methodology are also treated as partial use. A regular system of rating controls ensures that the target level of rating cover of 92 per cent is met.

The CRSA is used for individual business segments at NORD/LB Luxembourg and NORD/LB CFB, i. e. for savings bank guaranteed lending business, current account overdrafts and Lombard loans. Permanent partial use was authorised by the Luxembourg Financial Supervisory Authority CSSF.

Deutsche Hypo currently still uses the CRSA for loans and advances to central governments, foreign local authorities and companies which do not fall under real estate banking customer rating (temporary partial use).

In the case of securitisation transactions, the choice of method at NORD/LB, NORD/LB Luxembourg and Deutsche Hypo for calculating capital requirements, CRSA or IRBA, also depends on the underlying pool of receivables. More information can be found in Section 5.1.8.2. Securitisation transactions have so far not been relevant for NORD/LB CFB. Since the second quarter of 2013 Bremer Landesbank has also no longer had any securitisation transactions in its portfolio.

4.2.1.2 Investment Risks and Investment Funds

When calculating the minimum capital requirements, the NORD/LB Group currently treats investments which are not subject to capital deduction fully in accordance with the transition rules and exceptions defined in the German Solvency Regulation. However, it is planned that the IRBA will be used.

Investments that were held in the portfolio prior to 1 January 2008 are treated based on the CRSA grandfathering rule in accordance with § 338 para. 4 of the German Solvency Regulation. Investments that are not covered by grandfathering rule are for the time being indefinitely exempted from the IRBA in accordance with § 70 no. 2 and no. 9 of the German Solvency Regulation and are also backed by equity in accordance with CRSA regulations. Compliance with the materiality threshold is monitored constantly. The same applies for Bremer Landesbank.

NORD/LB Luxembourg uses the grandfathering rule and the indefinite exemptions from the IRBA. The investments made by Deutsche Hypo are also treated using the IRBA or indefinitely exempted from the IRBA. Investments are not relevant for NORD/LB CFB.

Investment funds in the banking book are always treated using the look-through approach. If the look-through approach is not possible, investment shares are allocated to the investments CRSA exposure class. These exposures are then included in the calculation of capital at the simple risk weight for investments in accordance with § 98 of the German Solvency Regulation. Investment funds are not relevant for NORD/LB CFB.

4.2.1.3 Market-Price Risks

With regard to market-price risk, NORD/LB has employed an internal risk model for general interest-rate risks, for general and special share-price risks and for currency risks in order to ascertain the regulatory capital requirements. The standard approach is used for special interest-rate risks.

Bremer Landesbank generally uses the standard approach, in particular the duration method, for general interest-rate risks. Share-price risks are not relevant here. The same applies to NORD/LB Luxembourg. For Deutsche Hypo and NORD/LB CFB only currency risks plays a role and this is treated in accordance with the standard approach. As commodity risks have no significant relevance in the NORD/LB Group, no method was implemented here.

4.2.1.4 Operational Risks

The standard approach is used in the NORD/LB Group to calculate the equity capital required for operational risk.

4.2.2 Capital Requirements per Risk Type

Table 3 shows the regulatory capital requirements pursuant to § 325 para. 2 nos. 1–4 and § 330 para. 1 German Solvency Regulation for the NORD/LB Group, divided into the key risk types and displaying the approaches used. As a result of a reduction in volume, with credit risks the fall in risk-weighted assets (RWA) is primarily attributable to a reduction in exposures at default (EAD). Added to this is the transfer of the retail portfolio to IRB, resulting both in a move of the RWA from the CRSA to the IRB as well as a substantial reduction of the RWA. The fall of the RWA in the IRB portfolio is primarily due to losses in the shipping portfolio and the associated transfer of RWA to Expected Loss (EL) / regulatory IRB deficits in valuation allowances. Market-price risks have on the whole reduced significantly. The reduced risk in NORD/LB's internal model is attributable to several components, in particular the reduced risk in the trading book, which is mainly due to the reduction of exposures.

Table 3: Capital requirements

(in € million)	31 Dec. 2013	31 Dec. 2012
1. Counterparty risk	**4 933**	**5 692**
CRSA credit risks	**554**	**802**
Central governments	22	24
Regional governments and local authorities	56	62
Other public-sector entities	4	5
Multilateral development banks	–	–
International organisations	–	–
Banks	18	46
Covered bonds issued by banks	2	5
Corporates	364	427
Retail	30	133
Exposures secured by real estate	33	66
Investment certificates	1	1
Other exposures	13	11
Overdue exposures	13	22
IRBA credit risks	**4 191**	**4 707**
Central governments and central banks	48	62
Banks	498	495
Retail	57	–
Corporates	3 413	4 036
Other non-credit-obligation assets	174	114
Securitisations	**134**	**138**
CRSA securitisation transactions	0	28
IRBA securitisation transactions	134	110
Investments	**54**	**45**
CRSA investment values	43	38
Investment values with method continuation/grandfathering	50	50
IRBA investment values	11	7
– Simple risk-weighted approach	11	7
of which: Listed investments	11	–
of which: Not listed but included in a sufficiently diversified investment portfolio	–	–
of which: Other investments	0	7
– Internal model approach	–	–
– Investment values based on PD/LGD approaches	–	–
2. Market-price risks	**155**	**149**
Market-price risks in the standard approach	61	67
– Interest-rate risks	53	62
of which: Special price risk for securitisation exposures in the trading book	–	–
of which: Special price risk in the correlation trading portfolio	–	–
– Share-price risks	–	–
– Currency risks	8	5
– Commodity risks	–	–
– Other risks	–	–
Market-price risks is in the internal model approach	94	82
3. Operational risks	**392**	**387**
Operational risks in the basic indicator approach	–	–
Operational risks in the standard approach	392	387
Operational risks in the advanced measurement approach	–	–
Total	**5 480**	**6 229**

4.2.3 Capital Ratios

As shown in Table 4 in accordance with § 325 para. 2 no. 5 of the German Solvency Regulation, the overall ratio in accordance with § 2 para. 6 clause 2 and the core capital ratio of the significant group companies from a risk point of view exceed the regulatory minimum capital ratios of 8 per cent for total capital and 4 per cent for core capital as at the reporting date. The NORD/LB Group and its significant companies from a risk point of view which are subject to independent reporting requirements complied with the applicable regulatory regulations concerning equity capital throughout the year under review.

Compared to the previous reporting date both the overall ratio in accordance with § 2 para. 6 clause 2 of the German Solvency Regulation and the core capital ratio of the NORD/LB Group have risen slightly, because the risk weighted assets compared to the core capital have been decreased.

Table 4: Capital Ratios

	Overall ratio in accordance with § 2 para. 6 clause 2		Core capital ratio[1]	
(in %)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Consolidated banking group				
NORD/LB Group	14.3	13.8	11.8	10.9
Parent company (as a single institute)				
Norddeutsche Landesbank Girozentrale	18.6	17.8	15.5	14.0
Subsidiaries				
Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –	10.9	11.4	9.1	8.8
Norddeutsche Landesbank Luxembourg S. A.	18.8	19.3	16.4	16.8
Deutsche Hypothekenbank (Actien-Gesellschaft)[2]		14.0		9.9
NORD/LB COVERED FINANCE BANK S. A.	19.3	17.6	14.9	13.4

[1] Core capital ratio calculated as followed: Core capital for solvency purposes / risk-weighted assets.
[2] Because of the use of the waiver no Solvency Regulation (SolvV) report is produced for Deutsche Hypothekenbank any longer.

4.2.4 Risk-Bearing Capacity

The RBC model constitutes the methodical basis for monitoring compliance with the NORD/LB Group's risk strategies. This monitoring is carried out at group level by NORD/LB's Finance and Risk Control Division and by the respective risk control divisions at individual institute level. NORD/LB's Finance and Risk Control Division is responsible for the overall control and development of the group-wide RBC model.

The aim of the model is to aggregate and duly present the bank's risk-bearing capacity at both institute and group level. The monitoring and reporting process is conducted regularly and guarantees that the responsible bodies are promptly informed about risk-bearing capacity situation of the significant group companies from a risk point of view and the NORD/LB Group as a whole.

The NORD/LB Group's RBC model consists of the three pillars of going concern, gone concern and regulatory framework, in which the respective material risks (risk potential) are compared with the defined risk capital of the individual institutes and the group.

The RBC model assumes the going-concern scenario to be the appropriate approach. The overriding objective of this control committee is the independent continuation of the business as a going concern based on the NORD/LB Group's current business model even if all of the available cover pool is consumed by risks that have materialised. In the going-concern scenario risk potentials that are economically-calculated using a uniform confidence level of 95 per cent are compared with a risk capital which is calculated for the scenario of a bottleneck of free equity in accordance with the German Solvency Regulation with fixed minimum ratios (total capital and core capital) and adjusted for various aspects.

The second consideration level is the gone-concern scenario, which represents a secondary requirement in the RBC model. The gone-concern scenario considers a higher confidence level from a risk potential point of view of 99.9 per cent and compares the corresponding economically-calculated risk potentials with a risk capital that is based on the full regulatory capital.

The third consideration level of the RBC model is the regulatory scenario and the official notification of capital adequacy in accordance with the German Solvency Regulation. It considers the risk potentials calculated in accordance with regulatory requirements. The regulatory consideration is a strict supplementary condition in the RBC model.

The capital side, both in the gone-concern scenario and in the regulatory scenario, is based on equity and equity-like components which according to banking regulations are to be classed as equity. In the gone-concern scenario the risk capital is adjusted to take into account various aspects (e. g. with the consideration of hidden liabilities). In the event of the capital required to cover risks in the gone-concern scenario being consumed, it would basically no longer be possible for the bank to continue business under otherwise unchanged assumptions.

The design of the RBC model allows that the gone-concern scenario can provide stimulus for the going-concern scenario, which is relevant for the assessment of the risk-bearing capacity. However, impetus directly relevant for control is provided by the going-concern scenario. Strategic limits are derived from the consideration of risk-bearing capacity taking into account the allocations of risk capital in the group risk strategy based on the going-concern scenario.

When calculating risk-bearing capacity, risk concentrations are also considered, both within a risk type as well as across risk types. Concentrations within a risk type essentially concern credit risks as the most significant risk type for the NORD/LB Group. These are integrated via the internal credit risk model into the RBC model.

Concentrations across different risk types are considered by stress tests. When selecting the stress scenarios the NORD/LB Group's key business areas and risks are consciously used as guidelines for selection. In the process among other things industries, segments and regions are selected which have a significant impact on the group's risk situation. These risk concentrations are reported and monitored on a regular basis in the context of risk-bearing capacity with targeted stress tests.

In an extensive interview process, which covers a range of positions in the bank, issues are gathered behind which distinct concentrations might lie. These are prioritised and, if they are deemed significant, are subjected to a detailed scenario analysis. This scenario analysis is initially detached from the assumptions concerning concentration and diversification made in the measurement of risk potentials. In this respect this process constitutes a further independent method for assessing concentrations. The aim is to develop scenarios in which all of the material consequences can be captured in the Bank's relevant key indicators.

The relevant scenarios are ascertained at the level of the NORD/LB Group and are to be applied consistently in all of the individual companies in order to ensure comparability between the institutes and to ensure that the group values can be aggregated. At individual institute level further stress tests can be determined which take account of the key business areas. All of the scenarios and parameters are reviewed regularly and if necessary updated.

The utilisation of risk capital with risk potential for the individual risk types and the utilisation of risk capital in the relevant going-concern scenario for the NORD/LB Group can be found in the Forecast, Risk and Opportunities report in the management report of the NORD/LB Group.

4.2.5 Security Mechanisms at Association Level

In addition to an adequate supply of available capital for the NORD/LB Group, other mechanisms at association level are in place to secure the institute.

NORD/LB is a part of the security reserve of the landesbanks and giro centres and is also covered by the protection system of the Savings Bank Financial Group. In addition to the security reserve of the landesbanks and giro centres, this protection system comprises twelve other protection schemes which have been consolidated in accordance with their statutes under the umbrella of the Deutscher Sparkassen- und Giroverband (DSGV, German Association of Savings Banks and Girobanks).

The aim of the protection scheme of the Savings Bank Financial Group is to recognise risks and critical situations among the member banks as early as possible and to initiate counter-measures. In this case the joint liability scheme operates a risk monitoring system with which the risk positions of participating institutes are monitored by the monitoring committees of their respective protection schemes. These committees in turn report to a central transparency committee which watches over the general risk situation of the joint liability scheme.

The joint liability scheme combines the individual protection schemes in a united protection system within the savings bank financial group. The savings bank financial group thus assumes responsibility for the portfolio of its institutes and completely covers customers' deposits from its own resources (§ 12 of the German Deposit Guarantee and Investor Compensation Act). This makes the joint liability scheme a symbol of cooperation and internal stability of the savings bank financial group.

As a member of the security reserve for landesbanks and giro centres, Bremer Landesbank is also covered by the joint liability scheme of the savings bank financial group. NORD/LB Luxembourg and NORD/LB CFB are also secured as subsidiaries via the parent company NORD/LB. Deutsche Hypo is a member of the security reserve as an affiliated institute.

5 DISCLOSURES RELATING TO RISK TYPES

5.1 Credit Risk

5.1.1 Credit Risks Management

5.1.1.1 Credit Risks Management Strategies and Processes

For the NORD/LB Group lending business and the management of credit risks is a core competence that is to be permanently developed and extended. The NORD/LB Group sees itself as a reliable universal bank focusing on lending business and it positions itself with its customers accordingly.

In order to meet the specific requirements of each business segment, NORD/LB has established financing principles for the individual market segments classified in the strategic business segments as risk-relevant; these cover both market and back office divisions. These principles represent binding guidelines for new lending business and include the ratings of the target customers of the relevant market division.

New lending business focuses on concluding agreements with customers with a good credit rating. The NORD/LB Group also concentrates on business with borrowers of good standing in the capital market business. Business with customers who fall outside of the above credit rating focus is only conducted after careful consideration of their opportunity and risk profiles.

The controlling of the NORD/LB Group's credit portfolio takes into account opportunities and risks. The aim is to produce competitive profitability and ensure efficiency and flexibility in terms of the active management of credit risk positions in order to minimise unexpected losses.

The NORD/LB Group focuses regionally mainly on domestic business. Its foreign lending business focuses on developed countries and selected emerging markets. Regional concentrations are deliberately realised outside of Germany in the USA, Great Britain and France. In accordance with the business strategies of the NORD/LB Group, the focus in industries is on commercial shipping, aircraft, energy, the automotive industry (including automotive banks), real estate and the continually reducing portfolios of credit institutions, which are limited strategically to prevent risk concentrations.

Credit risk is quantified with the key risk figures expected loss and unexpected loss. Expected loss is determined on the basis of probability of default taking into account recovery rates. The risk premium, which must be collected in order to cover expected loss, is calculated using the same methods throughout the group.

Unexpected loss for credit risk is quantified group-wide with the help of an economic credit risk model for different confidence levels and a time frame of one year. The credit risk model used by the NORD/LB Group includes correlations and concentrations in the risk assessment and is subject to an annual review and validation.

The credit risk model calculates the unexpected losses at the level of the overall portfolio. The model used is based on the CreditRisk+ model. Using correlated sector variables, systematic industry effects are represented in the loss distribution. The estimated probability of default (PD) is based on the internal rating method. The loss given default (LGD) is determined on a transaction-specific basis. The credit risk model works with a simulation method which also takes into account specific interdependencies of borrowers, e.g. on the basis of Group structures. In addition to default losses, losses that might be caused by rating migrations are also considered.

The methods and procedures for risk quantification are agreed on between the risk control units in the significant group companies from a risk point of view in order to ensure standardisation throughout the group. Risk management is performed constantly and decentrally in the group companies.

In order to calculate equity capital required for credit risks, NORD/LB uses the Internal Ratings Based Approach (IRBA). This does not apply to a small number of portfolios, for which the Credit Risk Standard Approach (CRSA) applies. NORD/LB has the relevant authorisation for its rating systems, for the Internal Assessment Approach (IAA) for securitisations and for the use of credit risk mitigation techniques. Further portfolios are to be gradually migrated from the CRSA to the IRBA.

Bremer Landesbank, NORD/LB Luxembourg, NORD/LB CFB and Deutsche Hypo (taking into account the waiver option) have also received authorisation for the relevant rating systems and approval to use credit risk mitigation techniques.

5.1.1.2 Credit Risks Management Structure and Organisation

A risk-related organisational structure and the functions, responsibilities and authorisation of divisions involved in risk processes are clearly defined at employee level. In accordance with the MaRisk Management, processes in lending business are characterised by a clear organisational separation of the market and back office divisions, right through to management level.

NORD/LB market divisions conduct the operational financing business relating to customers, properties and projects on a national and international level within a framework of specified limits. They are primarily responsible for the core tasks of acquisition and sales. The market divisions are responsible for the initial vote, for structuring conditions and for earnings. In the case of minor-volume, low-risk exposures, the market divisions will in some cases also bear sole responsibility for the risk (unilateral authorisation) as well as responsibility for analysing and observing these risks.

Tasks relating to analysis (including assigning ratings) and risk observation as well as the specification of collateral values are combined in the Credit Risk Management (CRM) back office division. Real estate and special appraisals are exceptions here; these are carried out in a separate, market-independent valuation management process. The Credit Risk Management Division is also responsible for the second vote taken for decisions on individual loans. Exposures with a concentration of risks are also subjected to a credit rating process in respect of large exposure management. In a multi-stage reporting system, the division also prepares segment portfolio reports on selected sub-segments at regular intervals.

The Credit and Securities Management division in the CRM is responsible for implementing the credit decisions for risk-relevant exposures including the contract documentation and for managing portfolios. With special finance the respective market division is responsible for these tasks.

The central management of risk concentrations in the NORD/LB Group’s credit portfolio is the responsibility of the Credit Portfolio Management group which is part of the CRM. Concentrations are examined with regard to the size an economic borrower entity in accordance with § 19 para. 2 of the German Banking Act as well as by country and industry.

The processing of non-performing exposures or exposures requiring debt readjustment is the responsibility of the Special Credit Management (SCM) Division at NORD/LB. Credits with a rating of 11 on the rating master scale of the German Association of Savings Banks and Girobanks (Deutscher Sparkassen- und Giroverband (DSGV)) (i. e. allocation to the “high risk” category in accordance with the “Initiative Finanzstandort Deutschland” (IFD, initiative for Germany as a financial location) or lower must be reported to the SCM division. Other defined indicators of risk (e. g. suspicion of behaviour not in the interests of creditors or the initiation of restructuring processes) may also require reporting. The SCM decides whether it will assume full responsibility, whether coaching is to take place or whether the exposure remains in the Market or CRM division with intensive support. From a rating of 16 (allocation to the IFD Default risk category (non-performing loans)), the SCM division is obliged to take over responsibility for an exposure. Exceptions are made with both the reporting requirement and assuming of responsibility for low-risk business and business-specific reasons. For financial institutions including central governments and foreign regional authorities, asset-backed securities (ABS) and corporate bonds, processing takes place in the Credit Risk Management Division.

Credit decision competences are classified in accordance with the total loan eligible and the rating of a borrower. Credit decisions are always taken by an authorised person in authority in a market division and an authorised person in a back office division (bilateral authorisation). The second vote is prepared in units independent of the market divisions in accordance with specified criteria. In addition to fulfilling the regulatory requirement of functional separation for credit assessments, this ensures that first-class credit decisions are taken on the basis of unified standards.

The Managing Board is responsible for controlling NORD/LBs credit portfolio. In performing its tasks, the Board consults among other things the Group Risk Committee, which ensures that a link between individual credit decisions and portfolio management is given and takes into account all risk types. The GRC recommends to the Managing Board various instruments for this purpose such as the ordering of an acquisition stop, the limiting of national, industrial or borrower-related concentrations or making recommendations relating to the placement of exposures and sub-portfolios. Within the general guidelines set by the Managing Board, where necessary the GRC also determines individual strategies for individual borrower entities, countries and industries within the strategic limit systems. The individual credit decision remains the responsibility of the Managing Board.

From a certain volume, decisions are taken by the Managing Board or by the General Working and Credit Committee (AAKA), a sub-committee of the Supervisory Board of NORD/LB. The AAKA participates in the process of granting loans in accordance with an authorisation regulation passed by the Supervisory Board. The acquisition of investments also requires the approval of the Supervisory Board, as do loans to executives.

The Strategy and Models Department of the Finance and Risk Control Division is responsible for the methods for measuring credit risks and for credit risk control instruments. It is responsible together with the Management Information Systems Department for the independent monitoring of credit and investment risk at portfolio level and for the corresponding report system as well as the regulatory reporting system. The Strategy and Models Department is also responsible for the methods used for the economic quantification of counterparty risk.

At Bremer Landesbank independent back office tasks are carried out by the Back Office Financing department. In addition to casting a second vote, it verifies and stipulates rating levels, verifies collateral values, processes and supervises of debt restructuring and work-out exposures and loan loss provisions, and shapes the policies and procedures for the lending business. Exposures beyond the scope of rating categories 1 to 8 are supervised more intensively or are handed over for restructuring to the unit bearing the same name. This unit is principally responsible for deciding on how an exposure is to be monitored in future or whether it is to be cancelled and coercive measures are to be implemented by a separate back office unit. The tasks relating to independently monitoring risks at portfolio level and to independent reporting are the responsibility of the Risk Control Division in the area of overall bank management and the Back Office Management group.

Risk management at NORD/LB Luxembourg and NORD/LB CFB is based on the concepts of NORD/LB and is regularly improved in accordance with commercial and regulatory criteria. Credit decisions are made in accordance with the back office vote of the authorised persons in the Credit Risk Management division of NORD/LB Luxembourg. The independent monitoring of the portfolio is carried out by the Risk Control Division at NORD/LB Luxembourg. NORD/LB's SCM division and the CRM division of NORD/LB Luxembourg are responsible for monitoring loans requiring comment or debt restructuring.

The risk management of Deutsche Hypo is performed based on Group-wide standards and is the subject of continual development. The second vote for credit transactions is performed by the back office division Credit Risk Management. The exposures requiring debt restructuring are looked after by the SCM division of Deutsche Hypo, either intensively with the goal of out-of-court restructuring or with defaulting counterparties also with the goal of realising collateral. The local risk control division monitors the risks of Deutsche Hypo at portfolio level.

5.1.1.3 Credit Risks Cover and Mitigation

A specific limit is stipulated for each borrower at individual transaction level within the scope of operational limiting in order to manage risks; this has the character of an upper limit. The significant parameters applied for deriving this limit are a borrower's creditworthiness, expressed as a rating, and the funds that are available at the borrowers free disposal for making principal payments when servicing a loan.

Risk concentrations and correlations at portfolio level are shown by quantifying the credit risk potential in the credit risk model. Risk concentrations are also limited by country and industry limits at portfolio level as well as by the Large Exposure Management model for borrower entities. The latter defines a loss-at-default limit for every rating on the basis of which a Group exposure for the categories corporates, financial institutes, special finance and foreign regional authorities is classified as being normal, as having risk concentration or having strong risk concentration. The exposure limits are based on the risk-bearing capacity of the NORD/LB Group.

Methods of mitigating credit risks are described in section 5.1.7.

5.1.1.4 Credit Risk Reporting

NORD/LB's Finance and Risk Control Division draws up among other things the Finance and Risk Compass for NORD/LB which shows and analyses all the significant structural features and parameters required for controlling the credit portfolio of the NORD/LB Group. The Finance and Risk Compass also includes in-depth analyses and stress scenarios relating to the credit portfolio. It is submitted to the Managing Board on a quarterly basis and is further specified for individual sub-segments by Industry Portfolio Reports from the Credit Risk Management division.

The Managing Board of NORD/LB also receives from the CRM further regular reports and reports as and when required on the credit portfolio of the NORD/LB Group and NORD/LB, e. g. on risk concentrations with borrower entities, country and industry concentrations and exposures which need to be monitored (credit watchlist).

At Bremer Landesbank the Managing Board is informed of credit risks within the scope of the credit portfolio report. The credit risk report is prepared on a quarterly basis and supplements the monthly RBC report. The Managing Board also receives on a monthly basis a report on an individual borrower basis on intensive and problem exposures and a report to identify and monitor risk concentrations at the level of borrower entities (large exposure management).

For NORD/LB Luxembourg and NORD/LB CFB the Financial Reporting Division prepares together with the Credit Risk Management division a counterparty risk report on a quarterly basis as part of the management information system for the Managing Board and the Credit Risk Committee in order to make existing risks and risk concentrations transparent and to initiate measures where necessary.

Deutsche Hypo prepares a risk report on a quarterly basis in accordance with the MaRisk Management. This report informs the Managing Board and the Supervisory Board in detail about the Bank's risk situation.

5.1.2 Credit Portfolio Structure

Tables 5 to 7 show the volume of exposure values by credit exposure excluding investment exposures and securitisations in accordance with § 327 para. 2 nos. 1–4 of the German Solvency Regulation. The exposures are broken down by industry, region and residual contractual maturity. Exposure values were ascertained prior to the inclusion of credit risk mitigation methods and after inclusion of the credit conversion factor (CCF) in accordance with § 48 and § 99 of the German Solvency Regulation. The credit equivalent amount was reported for derivative instruments.

Table 5: Credit exposures by industries

Industry	Credits, commitments and other non-derivative off balance sheet assets		Securities		Derivative financial instruments	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Financing institutes/insurance companies	54 526	71 751	30 008	33 904	4 175	5 595
Service industries/other	63 695	64 950	19 662	21 630	2 121	2 582
Transport/communications	23 027	28 819	409	393	430	706
Manufacturing	5 165	5 461	595	395	386	575
Energy, water and mining	12 218	11 311	539	493	411	574
Trade, maintenance and repairs	3 454	3 277	97	33	127	129
Agriculture, forestry and fishing	1 809	1 647	27	28	4	7
Construction	2 205	2 254	45	49	97	138
Total	**166 099**	**189 469**	**51 382**	**56 924**	**7 751**	**10 306**

Table 6: Credit exposures by regions

Region	Credits, commitments and other non-derivative off balance sheet assets		Securities		Derivative financial instruments	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Euro countries	143 780	162 887	45 193	50 363	5 363	7 489
of which: Germany	118 359	138 364	28 038	32 325	2 350	3 964
Remainder of Europe	7 870	9 764	2 239	2 294	1 413	1 639
North America	5 184	7 410	2 337	2 928	811	1 058
Central and South America	1 653	2 024	159	179	10	20
Middle East/Africa	1 172	1 115	–	20	2	1
Asia/Australia	4 552	4 233	1 088	1 140	152	98
Others	1 889	2 036	366	–	–	–
Total	**166 099**	**189 469**	**51 382**	**56 924**	**7 751**	**10 306**

Table 7: Residual contract maturities[1)]

Maturities	Credits, commitments and other non-derivative off balance sheet assets		Securities		Derivative financial instruments	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
> 0 years to ≤ 1 year	37 863	52 573	7 144	8 787	1 284	1 477
> 1 year to ≤ 5 years	39 117	40 564	29 320	31 996	3 042	3 844
> 5 years, no term	89 118	96 332	14 918	16 140	3 425	4 984
Total	**166 099**	**189 469**	**51 382**	**56 924**	**7 751**	**10 306**

1) The reference date was adjusted retrospectively.

The test pursuant to § 327 para. 2 no. 1 German Solvency Regulation showed that the amount of derivative financial instruments reported as at 31 December 2013 lies considerably below the average amount (€ 9,019 million). The further amounts do not differ substantially from the average amounts of the reporting period.

5.1.3 Risk Provisioning

Exposures are inspected at regular intervals, i. e. in a system of scheduled loan monitoring, in order to ascertain whether the claims of the NORD/LB Group are recoverable or whether interest and principal payments appear to be totally or partly at risk. A review is also carried out when negative information is received (early warning indicators) about a borrower, for example information relating to the borrower's financial situation, collateral value and industry environment as well as when establishing the reason for default (and issuing a default rating). Objective indications which might result in the need for a valuation allowance are for example the default on interest and capital payments or a delay in such payments of more than 90 days and considerable financial difficulties on the part of the debtor.

Since reports in accordance with the German Solvency Regulation are currently made on the basis of the accounts prepared in accordance with the German Commercial Code in the NORD/LB Group, information is also provided on loan loss provisions in accordance with the German Commercial Code at this point. For information on the accounting policies for loan loss provisions in accordance with IFRS the notes to the consolidated financial statements (Note 8) in the annual report are referred to.

For acute counterparty risks relating to lending business reported in the balance sheet, if there are objective indications of a permanent loss in value NORD/LB Group makes specific valuation allowances and lumpsum specific loan loss provisions. A need for valuation allowances is based on a present value consideration of anticipated interest and redemption payments which are still expected as well as on profits from the realisation of collateral.

NORD/LB takes account of latent counterparty risk relating to transactions with non-banks for which no specific valuation allowances are established by establishing general loan loss provisions. Risks relating to off-balance sheet transactions (guarantees, endorsement liabilities and loan commitments) are accounted for by a loan loss provision.

Irrecoverable loans of up to € 10,000 for which there is no valuation allowance are written off immediately. Payments received for written-off loans and advances are recognised through profit or loss.

In accordance with § 327 para. 2 nos. 5 and 6 of the German Solvency Regulation, Tables 8 to 10 show non-performing loans and loans in default excluding investment exposures and securitisation transactions by industry and region, and the development of risk provisioning in the reporting period. In the classification by industry, retail business is also reported. Lumpsum specific loan loss provisions are included in the specific valuation allowances. NORD/LB Luxembourg and NORD/LB CFB have been included with general valuation allowances in accordance with IFRS. Lumpsum specific loan loss provisions and general loan loss provisions, direct write-offs and additions to receivables written off are reported as a total amount and are not broken down by industry or region.

In order to distinguish between non-performing loans and loans in default, the three default rating classes 16 to 18 are used taking into account the default criteria in accordance with § 125 of the German Solvency Regulation. Rating 16 covers the default reasons of default of payment/overdrawn for more than 90 days and unlikely repayment. Rating 17 covers the default reasons of restructuring / rescheduling of debts / capital reconstruction and impairment / write-down. Rating 18 covers the default reasons of rating-induced cancellation / repayment (only DSGV method), complete write-off / abandonment, factoring with significant rating-induced loss and insolvency (request) / coercive measures.

For rated CRSA and IRBA positions, all the non-performing exposures are equivalent to rating grades 17 and 18. All the remaining past-due receivables are included in rating grade 16. Unrated CRSA positions in the past due exposure class are allocated to the respective category on the basis of specific characteristics. Exposure values are stated.

Table 9 also includes for the regions the changes in specific valuation allowances, lumpsum specific loan loss provisions, general loan loss provisions, provisions, direct write-offs and additions to receivables written off. This reporting goes beyond the requirement of § 327 para. 2 no. 5 of the German Solvency Regulation, but was chosen for reasons of transparency and uniformity – consistent with Table 8 with the breakdown by industry.

Table 8: Non-performing loans and loans in default by industries

Industry (in € million)	Non-performing loans and loans in default (requiring a write-down)	Specific valuation allowances	Lump-sum specific/general loan loss provisions	Provisions	Changes in specific valuation allowances	Changes in lumpsum specific/general loan loss provisions	Changes in provisions	Direct write-offs	Receipts for written-off loans	Defaulted loans (not requiring a write-down)
Financing institutes/insurance companies	54	114		15	– 20		11			21
Service industries/other	1 177	465		30	– 82		0			97
Transport/communications	3 571	1 117		9	410		– 22			2 138
Manufacturing	203	108		17	30		– 6			60
Energy, water and mining	79	49		26	– 4		4			67
Trade, maintenance and repairs	49	15		3	– 7		3			12
Agriculture, forestry and fishing	9	6		0	1		– 0			3
Construction	46	40		13	– 35		– 1			2
Retail	33	30		0	– 51		– 1			11
Total 31 Dec. 2013	**5 221**	**1 946**	**212**	**113**	**242**	**– 5**	**– 11**	**138**	**21**	**2 410**
Total 31 Dec. 2012	4 595	1 704	217	126	343	– 41	9	95	15	1 759

Table 9: Non-performing loans and loans in default by regions

Region (in € million)	Non-performing loans and loans in default (requiring a write-down)	Specific valuation allowances	Lump-sum specific/general loan loss provisions	Provisions	Changes in specific valuation allowances	Changes in lumpsum specific/general loan loss provisions	Changes in provisions	Direct write-offs	Receipts for written-off loans	Defaulted loans (not requiring a write-down)
Euro countries	4 734	1 816		92	353		– 15			2 226
of which: Germany	4 033	1 561		86	283		– 13			1 933
Remainder of Europe	163	65		14	– 86		– 4			58
North America	107	22		7	– 49		8			–
Central and South America	0	1		–	1		–			–
Middle East/Africa	156	36		0	27		0			32
Asia/Australia	60	6		0	6		0			94
Others	–	–		–	– 10		–			–
Total 31 Dec. 2013	**5 221**	**1 946**	**212**	**113**	**242**	**– 5**	**– 11**	**138**	**21**	**2 410**
Total 31 Dec. 2012	4 595	1 704	217	126	343	– 41	9	95	15	1 759

Table 10: Development of risk provisioning

(in € million)	Opening balance for the period	Adjustments/ allocations in the period	Reversal	Utilisation	Exchange rate related and other changes	Closing balance for the period
Specific valuation allowance	1 704	1 038	365	362	– 70	1 946
Lumpsum specific/ general loan loss provisions	217	14	18	– 0	– 0	212
Provisions	126	80	66	22	– 4	113

5.1.4 Disclosures on IRBA Exposures

5.1.4.1 Internal Rating Methods

In order to assess credit risks in the NORD/LB Group, each borrower is rated within the framework of an initial or annual credit rating process and a cause-related rating or credit rating category is also determined for each borrower. The rating modules employed were either developed in various cooperation projects conducted by the savings bank financial group or the Landesbanks or they were developed internally by NORD/LB.

The classification is based on the standard IFD rating scale which the banks, savings banks and associations in the “Initiative Finanzstandort Deutschland” (IFD, initiative for Germany as a financial location) have agreed on in order to improve comparability between the rating levels of the individual banks. The rating classes of the 18-step DSGV rating master scale used in the NORD/LB Group can be transferred directly into the IFD classes.

NORD/LB uses segment-related rating methods for estimating the anticipated probability of default of an external counterparty. The methods developed in cooperation projects are standardised to comply with the probabilities of default in the DSGV rating master scale. The master scale shows risks in comparable stages, makes the ratings of various segments comparable and facilitates communication. It is also comparable with external ratings. Each rating method results in a probability of default (PD) and the related rating grade. Both the rating excluding transfer risk (local currency rating) and the rating after offsetting a transfer risk (foreign currency rating) are reported.

At present 15 internal rating methods developed by NORD/LB in collaboration with its cooperation partners have been authorised by the regulatory authorities for the IRBA system. The rating methods for country and transfer risks as well as for international authorities are predominantly allocated to the Central Government exposure class, and the rating method for banks to Banks exposure class. Other rating methods belong to the corporate exposure class, i. e. corporates, insurance companies, leasing, DSGV standard rating, DSGV minor customer rating, DSGV real estate business rating, shipping financing, aircraft financing, project financing and international real estate financing. At the end of 2013 savings bank client scoring was added to the rating class.

NORD/LB also employs a rating classification method in accordance with the internal assessment approach (IAA) which was developed internally and has also been authorised by the regulatory authorities for securitisation transactions. In this case a rating grade in accordance with the scale of the rating agency Standard & Poor’s is ascertained for IAA-eligible securitisation positions. Detailed information on the internal rating methods for securitisations can be found at section 5.1.8.2.

The allocation of borrowers to the rating systems is regulated by the scope of application defined in the rating process. The principle of dual control is applied for all the ratings. A rating can only be released in this case by the relevant back office unit.

There is no rating procedure for investments. If they are processed in the IRBA system, simple risk weights in accordance with § 98 of the German Solvency Regulation are used.

The rating and scoring methods named, with the exception of the rating method for securitisation transactions, were developed in association projects, with NORD/LB cooperating with the savings bank organisation. They are updated, validated and improved by the maintenance units of the DSGV (Sparkassen Rating und Risikosysteme (SR) GmbH, Berlin) and the Landesbanks (Rating Service Unit (RSU) GmbH & Co. KG, Munich).

Mathematical-statistical methods are used to develop the processes. On the one hand (borrower-oriented) scorecard methods which assess quantitative and qualitative factors are used. These are converted to point scores and allocated to probabilities of default and rating grades in the form of a total number of points. On the other hand (asset-related) simulation methods in which projected payment flows are analysed and in turn supplemented with qualitative information are also used. A common element of all the methods is that they assess a credit rating on the basis of characteristics relevant to creditworthiness and condense them to produce a rating grade that is calibrated on the PD master scale.

The rating methods are all subjected to an annual process of validation comprising both quantitative and qualitative analyses. In this case rating factors, the definition and the calibration of methods, data quality and the entire structure of the model are reviewed on the basis of statistical and qualitative analyses as well as user feedback. The aim of calibration here is to match the empirical defaults actually observed as closely as possible to the probabilities of default predicted with the help of the rating methods.

In NORD/LB the Strategy and Models Department in the Finance and Risk Control Division is responsible for monitoring counterparty risk. It is responsible for controlling ratings, which must be done by each institute, in an internal validation of rating methods. This includes the following tasks:

- Administrating and supervising the rating methods
- Cooperating in SR / RSU validation activities
- Proving the representativeness of the rating methods based on data pooling
- Monitoring and reporting rating results and histories
- Implementing and monitoring the default and recovery concept
- Ensuring the correct application of the rating methods and communicating the results of plausibility tests

For counterparties which cannot be allocated to any of the specified rating methods, a quality-based credit rating method is used, with credit ratings ranging from A (very good) to F (undergoing liquidation).

Bremer Landesbank and Deutsche Hypo use the same basic rating method as NORD/LB. NORD/LB Luxembourg and NORD/LB CFB assess credit risk in close cooperation with NORD/LB on the basis of the rating methods specified.

5.1.4.2 Using Internal Assessments for Purposes Other than Ascertaining Risk-Weighted Exposure Values in Accordance with the IRBA

In addition to ascertaining risk-weighted exposure values, internal estimations of the PD and the LGD are important parameters for risk management and credit processes.

In preliminary costing (pricing) target margins, i. e. minimum margins and full-cost margins, are calculated. In the credit pricing calculator (CPC) for risk-adjusted pricing in lending business, the probabilities of default from internal rating procedures and internal estimated loss rates are included in calculating risk cost as a premium for expected loss. The calculation of equity costs as a premium for unexpected loss is based on the probabilities of default associated with the internal ratings and the regulatory loss rates.

As already described in Section 5.1.1.2 on credit risk management structure and organisation, the level of credit decision authority is also contingent on the rating of a borrower. Allocation to the segment for problem loans and the authority of the SCM Division is undertaken on the basis of rating grades.

The NORD/LB Group manages its risk-bearing capacity along economic lines subject to the proviso that all regulatory requirements are complied with. The results of the internal rating procedures are included in the examination of the risk-bearing capacity. Details on the RBC model can be found in section 4.2.4 on risk-bearing capacity.

5.1.4.3 Credit Volumes and Losses in the IRBA Portfolio

Table 11 shows the total credit volume included in the IRBA, broken down by PD grades, in accordance with § 335 para. 2 nos. 1 and 2a and c of the German Solvency Regulation. In addition to the exposure at default (EAD), average probabilities of default (average PD) and average risk weights (average RW) are reported. Exposure values after credit risks mitigation are used as a basis.

With regard to Tables 11 and 13, investments only need to be disclosed as a separate portfolio when the PD / LGD approach is used for investment exposures in the banking book. This currently does not apply in the NORD/LB Group. A separate presentation of items in accordance with § 335 para. 2 no. 1 of the German Solvency Regulation, for which separate LGD and CCF estimations are made, is not carried out since the advanced IRBA is not relevant for the NORD/LB Group.

The average PD (not including default) has improved from 1.1 per cent to 1.0 per cent, while the average risk weight (not including default) has improved from 49.4 per cent to 48.5 per cent.

Table 11: Total credit volume by PD grades (not including retail) [1)]

Portfolio	EAD (in € million)	Ø PD (in %)	Ø RW (in %)
		0 % ≤ PD ≤ 0,5 %	
Central governments	6 282	0.0	6.0
Banks	28 143	0.1	18.4
Corporates	42 917	0.2	34.3
Investments	–	–	–
Total 31 Dec. 2013	**77 343**	**0.1**	**26.3**
Total 31 Dec. 2012	83 816	0.1	24.6
		0,5 % < PD ≤ 5 %	
Central governments	223	0.6	81.5
Banks	2 118	1.2	76.3
Corporates	20 353	1.6	93.8
Investments	–	–	–
Total 31 Dec. 2013	**22 694**	**1.5**	**92.0**
Total 31 Dec. 2012	27 697	1.5	91.4
		5 % < PD ≤ 100 %	
Central governments	0	19.0	249.1
Banks	62	4.5	117.0
Corporates	4 630	13.4	206.4
Investments	–	–	–
Total 31 Dec. 2013	**4 692**	**13.3**	**205.2**
Total 31 Dec. 2012	5 975	13.0	203.2
		Total (not including default)	
Central governments	6 506	0.0	8.6
Banks	30 323	0.2	22.7
Corporates	67 901	1.5	63.9
Investments	–	–	–
Total 31 Dec. 2013	**104 729**	**1.0**	**48.5**
Total 31 Dec. 2012	117 488	1.1	49.4
		Default	
Central governments	0	0.0	0.0
Banks	29	100.0	0.0
Corporates	7 137	100.0	0.0
Investments	–	–	–
Total 31 Dec. 2013	**7 166**	**100.0**	**0.0**
Total 31 Dec. 2012	5 303	100.0	0.0

[1)] The reference date was adjusted retrospectively.

For the first time Table 12 shows the total credit volume included in the retail IRBA, broken down by PD grades, in accordance with § 335 para. 2 nos. 2 and 3 of the German Solvency Regulation. In addition to the exposure at default (EAD), average loss given defaults (average LGD), average probabilities of default (average PD) and average risk weights (average RW) are reported. Exposure values after credit risks mitigation are used as a basis. The reference date is not reported due to the introduction of the IRBA for the retail business in 2013.

Table 12: Total credit volume by PD grades (retail)

Portfolio	EAD (in € million)	Ø LGD (in %)	Ø PD (in %)	Ø RW (in %)
		0 % ≤ PD ≤ 0,5 %		
mortage-backed exposures	1 557	37,9	0,2	14,0
qualified rolling-over exposures	404	39,8	0,1	1,7
other exposures	306	39,0	0,1	12,1
Total 31 Dec. 2013	**2 267**	**117**	**0,4**	**27,7**
		0,5 % < PD ≤ 5 %		
mortage-backed exposures	402	39,1	1,3	55,7
qualified rolling-over exposures	32	39,9	1,8	23,9
other exposures	87	38,1	1,6	43,6
Total 31 Dec. 2013	**521**	**117**	**4,7**	**123,2**
		5 % < PD ≤ 100 %		
mortage-backed exposures	55	40,4	15,4	198,1
qualified rolling-over exposures	3	40,2	12,6	79,7
other exposures	13	37,9	17,5	78,2
Total 31 Dec. 2013	**71**	**118**	**45,4**	**356,0**
		Total (not including default)		
mortage-backed exposures	2.014	117	0,8	27,3
qualified rolling-over exposures	439	120	0,3	3,9
other exposures	406	115	1,0	21,0
Total 31 Dec. 2013	**2 859**	**352**	**2,1**	**52,1**
		Default		
mortage-backed exposures	31	13	100,0	176,8
qualified rolling-over exposures	0	10	100,0	135,4
other exposures	4	11	100,0	151,0
Total 31 Dec. 2013	**35**	**35**	**300,0**	**463,2**

Table 13 shows a comparison of expected and actual losses incurred in lending business for the current and two previous reporting periods in accordance with §335 para. 2 nos. 4 and 6 of the German Solvency Regulation. Retail is reported for the first time.

The loss estimation in this case is defined as the expected loss after credit risks mitigation and is based on the assumptions for regulatory loss rates in the event of default in accordance with § 93 and § 94 of the German Solvency Regulation. This is the expected loss of risk-weighted assets which have not defaulted in traditional lending business, i. e. excluding securities in the banking book and excluding derivatives. Traditional off-balance sheet business, such as credit commitments, is taken into account.

Actual losses comprise specific valuation allowances and direct write-offs less additions to receivables written off. They are only shown as a total amount and are not broken down by portfolio. Compared to the previous reporting period actual losses have fallen by € 4 million. The shipping portfolio was also the most affected segment for valuation allowances, but also for depreciations. Depreciations mainly concerned losses related to the sale of assets or restructuring.

Table 13: Expected and actual losses in lending business

	1 Jan. 2013 – 31 Dec. 2013		1 Jan. 2012 – 31 Dec. 2012		1 Jan. 2011 – 31 Dec. 2011	
(in € million)	Expected loss	Actual loss	Expected loss	Actual loss	Expected loss	Actual loss
Central governments	1		1		2	
Banks	15		12		15	
Corporates	2 234		1 792		529	
Mengengeschäft	22		–		–	
mortage-backed exposures	18		–		–	
qualified rolling-over exposures	1		–		–	
other exposures	3		–		–	
Investments	0		–		0	
Total	**2 271**	**322**	**1 806**	**326**	**546**	**304**

5.1.5 Disclosures on Standard Risk-Weighted CRSA and IRBA Exposures

The rating agencies Standard & Poor's, Moody's Investor Service Ltd. and Fitch Ratings were named for the purpose of risk weighting CRSA exposures and securitisation exposures.

External ratings are used for issuer, issue and country credit rating assessments, with the issue rating initially being used as a basis; the issuer rating is only referred to in the absence of an issue rating. Issue ratings are not applied to unrated CRSA exposures (e.g. loans). Country classifications by export insurance agencies are not taken into account.

Bremer Landesbank does not use any external ratings for CRSA exposures. Deutsche Hypo has also chosen the rating agencies Standard & Poor's, Moody's Investors Service Ltd. and FitchRatings for the CRSA exposure classes central governments, regional governments and local authorities, other public-sector entities, multilateral development banks, corporates and securitisation transactions. NORD/LB Luxembourg and NORD/LB CFB have only named Standard & Poor's and use the ratings for the central and regional government and bank exposure classes.

In accordance with § 328 para. 2 of the German Solvency Regulation, Table 14 contains an overview of CRSA exposure values before and after credit risk mitigation. CRSA credit risk mitigation techniques take account of indemnities and financial collateral. Mortgage liens as collateral are not considered as mitigating credit risk in the CRSA; instead the secured receivables are reported in the exposure class "exposures secured with real estate". The latter is no longer relevant for NORD/LB as in 2013 approval was granted for the use of IRBA for the retail business.

In some cases exposure values are higher in the after credit risk mitigation column. This is due to the allocation of exposure values or parts of exposure values at other risk weights after risk mitigation as well as from IRBA exposures in accordance with § 84 para. 1 of the German Solvency Regulation which are secured by a CRSA guarantor and are hence reported as CRSA exposures after risk mitigation.

IRBA exposure values are also shown in accordance with § 329 para 2 of the German Solvency Regulation, for which simple risk weights are applied for investments (investment funds without look-through).

Table 14: Counterparty risk exposures for portfolios in the CRSA and IRBA on application of regulatory risk weights

Risk weight	Volume of exposure values (in € million)					
	CRSA Before credit risk mitigation		CRSA After credit risk mitigation		IRBA (special financing and investments)	
(in %)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
0	85 756	105 111	90 401	103 517	–	–
10	76	76	76	76	–	–
20	3 263	3 986	3 652	4 243	–	–
35	52	119	455	1 563	–	–
50	975	1 185	981	1 106	–	–
70	–	–	–	–	–	0
75	1 013	3 812	501	2 216	–	–
90	0	0	5 538	–	–	–
100	11 294	11 446	2 320	8 267	–	–
115	–	–	–	–	–	–
150	137	187	119	165	–	–
190	–	–	–	–	–	–
250	–	–	–	–	–	–
290	–	–	–	–	–	–
350	–	–	–	–	–	–
370	–	–	–	–	1	24
1250	–	–	–	–	–	–
Capital deduction	–	–	–	–	–	–

5.1.6 Derivative Counterparty Risk Positions and Netting Positions

The NORD/LB Group employs derivative financial instruments for securing purposes in asset/liability management. Trading is also conducted in derivative financial transactions. Derivative financial instruments in foreign currencies are mainly concluded as forward-exchange contracts, currency swaps, interest rate/currency swaps and currency options. Interest derivatives primarily comprise interest rate swaps, forward rate agreements, interest rate options and interest rate caps/floors. Futures contracts are also concluded for fixed interest rate securities. Stock derivative agreements are mainly concluded as stock options and equity swaps. Additionally, credit derivatives in the form of credit default swaps are deployed.

Netting agreements covering derivatives are used in accordance with § 207 of the German Solvency Regulation. Eligible netting positions from derivatives are recognised at their marked-to-market replacement cost in accordance with §211 para. 2 of the German Solvency Regulation. The net measurement base for netting positions from derivatives is the amount resulting from the difference of positive and negative fair values of the transactions covered by the netting agreement plus a regulatory premium. The LeDIS system is used to check eligibility for netting.

Internal capital allocation for derivative counterparty risk positions and netting positions is carried out as part of the allocation of equity to credit risks described in section 4.2.4 on risk-bearing capacity.

Trades are only entered into with contractual partners for whom replacement risks and advance payment risks have been granted. All the trades concluded with a specific counterparty are offset against these limits. The risk subject is the counterparty/contractual partner for the trade. Replacement risks and settlement risks are taken into account in terms of limit utilisation.

Replacement risk defines the risk of the contract partner in a pending transaction with a positive present value defaulting and this transaction having to be replaced with a loss. § 19 of the German Solvency Regulation is thus applied for current potential replacement costs and § 20 of the German Solvency Regulation for expected future increases in current potential replacement costs.

In terms of the limiting of credits to counterparties, the same rules apply as those described in section 5.1.1.3 for covering and mitigating credit risks.

With regard to collateral, reference is made to section 5.1.7 on credit risk mitigation techniques.

Provisions / impairments are recognised to account for the risk of losses. More information can be found in section 5.1.3 on risk provisioning.

The measurement base for derivative counterparty risk positions follows the current exposure method. Eligible netting positions from derivatives are included at marked-to-market replacement cost. Table 15 shows the valuation of derivative counterparty risk positions before and after netting and collateral in accordance with § 326 para. 2 no. 1 of the German Solvency Regulation. The term "positive replacement cost" means the current potential replacement cost in accordance with § 19 of the German Solvency Regulation. This is equivalent to the current positive fair value.

Table 15: Positive replacement costs

(in € million)	Positive replacement costs before netting and collateral	Netting options	Eligible collateral	Positive replacement costs after netting and collateral
Interest-rate-based contracts	9 047			
Currency-based contracts	1 070			
Equity / index-based contracts	180			
Credit derivatives	62			
Commodity-based contracts	25			
Other contracts	–			
Total 31 Dec. 2013	**10 385**	**5 806**	**1 749**	**2 943**
Total 31 Dec. 2012	16 394	9 376	2 194	4 824

The counterparty risk to be allowed for in accordance with § 326 para. 2 no. 2 of the German Solvency Regulation is ascertained with the current exposure method and can be seen in Table 16. The counterparty risk position is determined here as a positive replacement cost after netting and collateral plus an add-on for expected future increases in value.

Table 16: Counterparty risk

(in € million)	Original exposure method	Current exposure method	Standard method	Internal model
Total 31 Dec. 2013	**–**	**6 462**	**–**	**–**
Total 31 Dec. 2012	–	9 095	–	–

Table 17 shows hedge transactions with credit derivatives in accordance with § 326 para. 2 no. 3 of the German Solvency Regulation, which are used in terms of the German Solvency Regulation to mitigate risk.

Table 17: Credit derivatives – nominal value of hedge transactions

	Nominal value of hedge transactions	
(in € million)	31 Dec. 2013	31 Dec. 2012
Credit derivatives (assignees)	–	65

Table 18 shows a breakdown of the nominal value of credit derivatives in acquisitions and sales in accordance with § 326 para. 2 no. 4 of the German Solvency Regulation. The NORD/LB Group did not conduct any brokerage activities for credit derivatives in the period under review.

Table 18: Credit derivatives – purpose

	Used in the banks own credit portfolio				Brokerage activities	
	Purchased		Sold			
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Credit Default Swaps	240	462	4 061	4 558	–	–
Total Return Swaps	–	–	516	693	–	–
Credit Linked Notes	–	–	–	–	–	–
Credit Options	–	–	–	–	–	–
Others	–	–	–	–	–	–

5.1.7 Credit Risks Mitigation Techniques

5.1.7.1 Collateral Management

For the assessment of credit risks, in addition to the credit rating of borrowers or counterparties reflected in the rating, the customary bank collateral available and other risk reduction methods are of importance. The NORD/LB Group therefore accepts domestic and foreign securities in the form of property and rights (collateral) to reduce credit risks. When accepting securities the cost-benefit relationship of the collateral is considered.

The collateral is assessed both at the time the loan is granted and during the subsequent ongoing (normally at least once a year) monitoring as to whether it appears to be disposable at the assumed value based on foreseeable economic developments during the (remaining) term of the loan. They are therefore reviewed on a case-by-case basis as to whether the valuation appears to be justified based on the respective type of security and based on its legal and economic applicability in respect of the person of the borrower and the type of loan. If factors relevant to the assessment have changed, the assessment is adjusted accordingly.

The credit guidelines and lending principles of the NORD/LB Group specify which fundamental types of security and the maximum loan which may be lent against the collateral (lending limit). Sureties, credit securities similar to sureties, assignments of receivables and other rights, chattel mortgages, real estate, receivables and other rights and collateral assignment of chattel are accepted as credit security. Other collateral can be contracted with the borrower, but this does not reduce the unsecured portion of the exposure.

The legal portfolio of collateral is maintained in the dedicated Collateral Management System which is also used for the inclusion of collateral when ascertaining minimum capital requirements and for regulatory reports.

In order to ensure the legal validity and enforceability of collateral, standard contracts are mainly used. In addition to this, external legal opinions are obtained and the preparation of contracts is assigned to authorised law firms. At the same time the relevant legislation is monitored continually. For foreign collateral, monitoring is performed by international law firms.

5.1.7.2 Collateral to Ease Equity Requirements

The NORD/LB Group has been authorised by the German Federal Financial Supervisory Authority (BaFin) to use mortgage collateral, other IRBA physical collateral, guarantees and financial collateral as credit risk mitigation techniques to ease capital requirements. Internal processes and systems operated ensure that only collateral which meets all the requirements of the German Solvency Regulation in terms of credit risks mitigation techniques is employed.

Mortgage liens as collateral relate to commercial and residential real estate. The properties are generally valued by independent internal appraisers and also by external surveyors appointed by the valuation department should this become necessary. The market fluctuation concept of the German Banking Industry Committee (Deutsche Kreditwirtschaft) is used to help continually monitor real estate values. This method is recognised as a statistical method in accordance with § 20a para. 6 of the German Banking Act. For the properties valued using the market fluctuation concept, the values are reviewed every three years by the internal appraisers if the mortgage lending value of property and loans secured by the property exceeds specified thresholds. For all other properties, this review takes place every year.

In the category other IRBA physical collateral, ships (NORD/LB and Bremer Landesbank), aircraft, engines (only NORD/LB) and wind energy plants (only Bremer Landesbank) are used to ease equity requirements.

Ships and aircraft must be entered in a public register and fulfil certain requirements such as marketability and age. An additional requirement in the case of ships is that they must have been constructed under the supervision of a recognised classification society and possess class certification issued by a classification society recognised by the German Banking Industry Committee. Aircraft must have been awarded internationally-recognised type and air transport approval. The initial valuation and valuation reviews of ships and aircraft are carried out by the Bank's independent internal appraisers based on external approval certifcates; they have to be carried out at least once a year to meet regulatory requirements.

The eligibility of engines for consideration is ascertained in a two-stage process. The compliance with minimum requirements for the consideration of engines as other IRBA physical collateral required by the German Solvency Regulation is, like ships and aircraft, ensured by the business policy documented in the organisational guidelines and the contract templates used. These requirements concern in particular the determination of the object, the degree of cover and the right of inspection.

The location of wind energy plants is decisive for their value. Before a plant is constructed, wind power is forecast in external reports and the effective exploitation of wind is compared with these forecasts at least once a year when the plants are in operation. The value of a plant is derived from its earnings in connection with the legally specified compensation for feeding electricity into the grid. The value of a wind energy plant is recalculated and lending values are re-stipulated in the event of significant deviations from forecasts. In order to be in a position to operate a wind energy plant alone if the need arises, the significant operator rights relating to location and rights resulting from supply contracts are normally assigned to it.

The guarantees considered in credit risks mitigation techniques are predominantly sureties and guarantees. The carrying amounts are based on the credit rating of the guarantor. The same rating rules apply as for all other borrowers. The main types of guarantors are public institutions and banks with a very good rating.

Concentration risks resulting from the acceptance of guarantees are monitored in connection with the direct exposure of the guarantor. If a guarantor without a 1 (AAAA) rating exhibits a warranty risk above the materiality threshold of € 10 million, this overshoot will be shown in the quarterly counterparty risk concentration report and country report of the NORD/LB Group. The warranty risk is determined on the basis of the guaranteed loan taking into account the twofold probability of default. There are currently no risks concentration in this respect.

Financial collateral is primarily cash deposits. In the trading sector repo transactions continue to be effected. Only cash collateral (NORD/LB Group as the transferor) as well as bonds whose issuers have a very good rating (NORD/LB Group as the transferee) is accepted. Transactions are therefore low risk. They are valued automatically every day and the back office of the trading division monitors counterparty lines daily on the basis of these valuations so that no concentration of risk arises. Additionally, market-price fluctuations in the scope of margin calls are settled daily in the form of bonds and cash deposits.

Tables 19 and 20 contain an overview of collateralised CRSA and IRBA exposure values for each exposure class in accordance with § 336 para. 2 of the German Solvency Regulation. Because of the approval of IRBA for the retail business, corresponding values are displayed in Table 20 for the first time. With derivatives netting agreements are considered. Investments only need to be disclosed as a separate portfolio when the PD/LGD approach is used for investment exposures in the banking book. This currently does not apply in the NORD/LB Group.

The exposure values reported are collateralised by eligible financial collateral in accordance with § 154 para. 1 clause 1 no. 1 of the German Solvency Regulation after the application of value fluctuation factors, guarantees in accordance with § 154 para. 1 clause 1 no. 2 of the Solvency Regulation and life insurance policies in accordance with § 170 of the Solvency Regulation and other IRBA collateral in accordance with § 154 para. 1 clause 1 no. 3 of the Solvency Regulation.

CRSA loans secured by mortgage liens are reported in the exposure class “exposures secured with real estate”.

Table 19: Total collateralised CRSA exposure values (not including securitisations)

	Financial collateral		Guarantees		Mortgage liens	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Central governments	–	–	1 024	1 272	–	–
Regional governments and local authorities	763	1 511	2 497	2 373	–	–
Other public-sector entities	21	1 747	88	149	–	–
Multilateral development banks	–	–	21	–	–	–
International organisations	–	–	–	–	–	–
Banks	925	4 511	1 564	1 492	–	–
Covered bonds issued by banks	–	–	37	130	–	–
Corporates	1 275	920	1 579	1 663	–	–
Retail	0	3	1	1	–	–
Exposures secured by real estate	–	–	–	–	821	1 509
Investment certificates	–	–	–	–	–	–
Investments	–	–	–	–	–	–
Other exposures	–	–	–	–	–	–
Overdue exposures	0	1	0	0	10	23
Total	**2 985**	**8 693**	**6 809**	**7 080**	**831**	**1 532**

Table 20: Total collateralised IRBA exposure values (not including securitisations)

	Financial collateral		Guarantees		Other IRBA collateral	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Central governments	2 282	–	1 268	1 585	338	123
Banks	5 890	11 607	318	447	38	39
Corporates	956	1 651	2 395	2 484	25 957	26 262
Retail	–	–	–	–	749	–
Investments	–	–	–	–	–	–
Total	**9 129**	**13 258**	**3 981**	**4 516**	**27 082**	**26 424**

5.1.7.3 Netting Agreements

In order to mitigate counterparty risk in trading the NORD/LB Group employs netting agreements covering derivatives.

Netting agreements are always multilateral. Only standard general agreements are used, Entering into new contracts on behalf of NORD/LB, NORD/LB Luxembourg and NORD/LB CFB is performed by the legal department. Legal enforceability of the netting agreements in the different jurisdictions is monitored by regularly obtaining legal opinions.

Contract data can be stored centrally in the dedicated LeDIS standard application. This system of data management enables an automatic examination of the individual derivative transactions to be carried out by the users of this information, for example the employees responsible for processing reports.

Netting agreements on money receivables and cross-product netting agreements are not used.

The volume of netting agreements covering derivatives can be seen in Table 15 in section 5.1.6 on derivative counterparty risk positions and netting positions.

Only cash collateral is currently accepted for securitising derivative transactions. Standard general agreements are also used here.

5.1.8 Securitisations

5.1.8.1 Aims, Functions and Scope of Securitisations

Securitisation is a further instrument available to the NORD/LB Group to control credit risks. The aim of these securitisation activities is to optimise the yield / risk profile of the loan portfolio and to ease regulatory equity requirements.

In order to diversify the loan portfolio, credit risks in the Bank's own books can transferred to other market participants (NORD/LB as an originator) or additional credit risks are taken (NORD/LB as an investor or sponsor). NORD/LB originated no new securitisation transactions in 2013. As a sponsor, the NORD/LB Group makes liquidity facilities available in order to improve the credit quality of the institute's own asset-backed commercial paper conduit programme Hannover Funding. The NORD/LB Group also conducts securitisation activities as an arranger of structured transactions in the interest of customers.

Securitisation transactions are all subject to a strict process of approval and monitoring, so that potential risks before and after the conclusion of a contract can be identified and regulated. The NORD/LB Group uses a risk classification system authorised by the regulatory authorities in accordance with the German Solvency Regulation as well as other approaches to assess the risk of securitisation transactions. The NORD/LB Group pursues a conservative exposure strategy in its role as investor and sponsor.

NORD/LB's exposure strategy focuses on a reduction portfolio and customer-oriented new business. Here the new business concentrates on bigger, selected customers of NORD/LB and offers the financing of receivables with the conduit Hannover Funding. The reduction business concentrates on sales and the reduction of risk-weighted assets while safeguarding profit interests.

NORD/LB Luxembourg acted for the first time in the year under review as a sponsor and investor of two securitisation transactions. As a sponsor, it provides a liquidity facility for the conduit Hannover Funding, as an investor the bank purchased receivables; this purchasing of receivables was guaranteed fully by NORD/LB. When measuring the value of securitisations, the bank uses the standard regulatory approach or the IRB approach.

Bremer Landesbank and Deutsche Hypo have no longer acted as investors in recent years in securitisation transactions. Bremer Landesbank no longer has a securitisation portfolio as at 31 December 2013; there is a strategy to reduce the remaining portfolio of Deutsche Hypo. Securitisation business has so far not been relevant for NORD/LB CFB.

The scope of securitisation activities in the NORD/LB Group can be seen in section 5.1.8.7 on quantitative information.

5.1.8.2 Procedures for Determining Risk-Weighted Exposure Values, Internal Assessment Approaches and Rating Agencies

NORD/LB employs the following methods for ascertaining risk-weighted exposure values:

- In the rating-based approach (RBA), risk weights depend on external ratings, the granularity of the pool of receivables and the seniority of tranches.

- The supervisory formula approach (SFA) is used for external unrated positions for which NORD/LB has sufficient up-to-date information on the composition of the securitised portfolio and is able to determine capital requirements prior to the securitisation transaction.

- Unrated securitisation exposures in the ABCP programme (excluding asset-back money market instruments) are valued with the internal assessment approach (IAA) method. The risk-weighted assets are determined based on the ratings obtained with the IAA, the granularity of the pool of receivables and the seniority of tranches.

- The look-through approach applies for investment funds. With the look-through approach the external credit ratings of the securitisation exposures in the investment fund are considered.

NORD/LB uses a total of five internal assessment approaches which take into account the regulatory requirements to assess certain securitisation exposures. Each specific internal assessment approach relates to one of the following exposure classes: Auto Leases, Auto Loans, Consumer Receivables, Insured Trade Receivables and Trade Receivables. The result of each internal assessment approach is a rating based on the rating scale of Standard & Poor's. The ratings are used to determine the equity requirements and are an important decision-making criterion for loan decisions, pricing and portfolio management.

NORD/LB's Finance and Risk Control Division is responsible for the development and maintenance of the internal assessment approaches, whereby changes to procedures are made on the basis of the four-eyes principle. The market divisions and the Credit Risk Management Department responsible for the transactions assessed with the internal assessment approaches are involved if there are any necessary changes in the international assessment approaches. Any decision on the nature and scope of the changes is made though by the Finance and Risk Control Division independently of these divisions. An annual validation of the internal assessment approaches is also conducted by this division. In addition to this, a review of the internal assessment approaches is conducted at regular intervals by NORD/LB's Internal Audit. The German Banking Supervisory Authority examined all of the internal assessment approaches before approving them.

The internal assessment approaches are structured in such a way that both a quantitative and qualitative part of the model influence the rating result. Quantitatively, the stress intensity that the respective transactions can withstand without incurring losses for NORD/LB is examined. For example, stress factors are applied to credit losses assumed in a base case as multipliers in order to simulate economic stress scenarios. Depending on the rating, these stress factors move between specific bands in accordance with the rating criteria of Standard & Poor's.

In the procedures for Auto Leases, Auto Loans and Consumer Receivables, a stress factor between 4.00 and 5.00 is applied for the rating AAA, between 3.00 and 4.00 for AA, between 2.00 and 3.00 for A, between 1.75 and 2.00 for BBB and between 1.50 and 1.75 for BB. For Trade Receivables and Insured Trade Receivables, NORD/LB again bases the stress factors it uses on Standard & Poor's, whereby the transactions involving risks are weighted with a stress factor of between 2.50 and 2.75 (AAA), between 2.25 and 2.50 (AA), between 2.00 and 2.25 (A) and between 1.50 and 2.00 (BBB). In addition to this, NORD/LB uses a range of other stress parameters which are based on the criteria of the rating agencies.

Qualitative components of NORD/LB's internal assessment approaches include valuation aspects which concern for example the management, organisation and receivables administration of the servicer or originator. The result of the qualitative model is a score which is used to determine the precise stress factors which are applied to a transaction for the various ratings.

For NORD/LB Luxembourg and Deutsche Hypo, the methods used also depend on the underlying pool of receivables. Deutsche Hypo uses both the RBA and SFA for IRBA receivables: it uses the rating-based approach for CRSA receivables. When measuring the value of securitisations, NORD/LB Luxembourg uses the standard regulatory approach or the IRB approach. As securitisation transactions have so far not been relevant for NORD/LB CFB, no process has been implemented here.

5.1.8.3 Liquidity and Operational Risks with Securitisation Transactions

Securitisation exposures held by the NORD/LB Group are assessed with regard to their degree of liquidity taking into account class and market information and are treated in accordance with their assessment in the liquidity management and control systems. Any use for the liquidity buffer required in accordance with MaRisk is restricted by the liquidity assessment taking into account diversification aspects and only takes place with the countervalue adjusted by haircuts. In addition to this, in stress scenarios the reduced marketability or saleability of the securities held is considered as potential liquidity risk by the application of scenario-specific deduction factors.

The liquidity facilities provided by NORD/LB as the sponsor of the institute's own ABCP conduit programme are considered separately.

Possible reasons for increased use of the facilities may be a significant fall in value of the deposited assets and / or a change in the rating of NORD/LB and as a result not all of the commercial papers being placed on the money market. These events are considered appropriately in the stress scenarios to measure and control traditional liquidity risk.

Operational risks in the NORD/LB Group's securitisation transactions are countered by the continuous training of the employees entrusted with these transactions, the legal support for the securitisation process and the intensive analysis of the associated legal and economic conditions. Process risks are analysed within the scope of the New Product Process (NPP), as are potential reputation risks which might be associated with securitisation transactions.

5.1.8.4 Processes for monitoring Counterparty and Market-Price Risks for Securitisations

In order to monitor changes in the counterparty and market-price risks of securitisation exposures in accordance with § 334 para. 1 no. 6 of the German Solvency Regulation, continuous portfolio screening takes place in NORD/LB. In order to review changes in the risk situation and the measures to take, various monitoring processes for every transaction on an individual transaction basis were implemented. These include the annual loan monitoring presentation, ad-hoc presentations in the event of negative events during the course of the year, the quarterly monitoring and review of the risk classification of risk-relevant exposures on the credit watchlist, the weekly monitoring of securities on the credit investment watchlist and the daily monitoring of rating changes on the ABS watchlist.

In addition to this, in 2013 an internal assessment of expected losses in different stress scenarios, which included an assessment of the securitisation portfolio and which supports the further optimisation and validation of necessary risk protection measures, took place. The findings are used as an additional source for identifying potentially risky exposures.

The value of securitisation exposures is primarily determined by the development of the underlying receivables. Structural components also need to be considered. These include in particular the legal protection against direct liability for the underlying receivable in the case of utilisation, the ranking of the securitisation exposures (tranches / seniority) based on the waterfall principle and the credit quality of the parties involved in the securitisation transactions.

5.1.8.5 Securitisation Special Purpose Entities

The NORD/LB Group acts as a sponsor for the securitisation special purpose entity Hannover Funding LLC (Hannover Funding).

Hannover Funding is a fully supported ABCP programme which is sponsored and managed by NORD/LB. Hannover Funding is a bankruptcy-remote special purpose entity with limited liability registered in Delaware, USA.

Hannover Funding typically acquires trade and leasing receivables which were generated by customers of NORD/LB (the "transaction") and refinances itself by issuing ABCP in the capital market. Hannover Funding can issue ABCP with a term of up to 270 days for USD commercial papers and up to 183 days for EUR commercial papers. Its income from issues is used to acquire loan receivables or to issue loans secured by receivables and similar assets. The commercial papers issued by Hannover Funding benefit from an extensive credit and liquidity commitment (Liquidity Asset Purchase Agreement – LAPA) granted by NORD/LB. In order to hedge the transaction, NORD/LB provides Hannover Funding with liquidity facilities in the amount of 102 per cent of the transaction volume committed to the customer. The relevant CRSA and IRBA exposure values are shown in Table 23.

The credit and liquidity commitments within the scope of the LAPA can be utilised by Hannover Funding at any time. If Hannover Funding utilises a liquidity facility, NORD/LB is obliged either to purchase the assets from Hannover Funding or to issue a short-term loan to Hannover Funding. Within the scope of the annual credit rate assessment process to renew the liquidity facility, NORD/LB assesses the credit quality of the transactions and decides whether to renew or end the liquidity facility.

Neither NORD/LB nor any company affiliated with NORD/LB holds shares in Hannover Funding. As the programme administrator, NORD/LB is responsible for determining and implementing the investment policy of Hannover Funding and decides which assets can be purchased and which transactions can be financed. As a bankruptcy-remote company, Hannover Funding can only incur liabilities by issuing commercial papers, necessary hedging obligations, drawings within the scope of the LAPA and other measures provided for by the articles of association. The financial processing and the generation of daily reports for the activities of Hannover Funding is outsourced to the service provider Global Securitization Services (GSS); its activities are monitored by NORD/LB employees. The administration of the securitisation transactions (including business policy decisions and contracts) is performed by NORD/LB in the Asset Backed Finance unit in New York.

NORD/LB does not transfer its own receivables to Hannover Funding; as a result NORD/LB only has to record off-balance-sheet counterparty risk positions (liquidity facility) with Hannover Funding. NORD/LB's loan receivables from its customers are not financed by Hannover Funding. The marketing of commercial papers issued by Hannover Funding has been performed to date by external processors. NORD/LB does not have any direct contact with investors when commercial papers are issued and does not provide them with any advice.

5.1.8.6 Accounting Policies for Securitisations

Since reports in accordance with the German Solvency Regulation are currently made on the basis of the accounts prepared in accordance with the German Commercial Code in the NORD/LB Group, information is provided on accounting policies in accordance with the German Commercial Code at this point. For information on the accounting policies for financial instruments in accordance with IFRS the notes to the consolidated financial statements (Note 7) in the annual report are referred to.

The method of reporting securitisation transactions depends on the type of securitisation. Basically there are two types of securitisations: synthetic and true sale securitisations.

With the securitisation transactions initiated as the originator, the assets are derecognised with true sale securitisations when they are transferred to a third party in accordance with the German Commercial Code.

The liquid facilities granted as the sponsor are reported in the balance sheet as irrevocable credit commitments in accordance with the German Commercial Code.

For the securitisation exposures acquired as an investor, different accounting polices apply depending on whether they are classified as fixed or current assets. In the NORD/LB Group these are only assigned to the banking book. For securities treated as fixed assets, write-downs to the lower of cost or market are made for securities with carrying amounts above par, but only down to a book price of a maximum of 100 per cent. Write-downs to the lower of cost or market are not charged for securities with carrying amounts below par provided the impairment is not expected to be of a long-term nature. Write-ups (appreciation in value in accordance with § 253 para. 5 of the German Commercial Code) are made up to the cost of acquisition, even in excess of 100 per cent. Furthermore, impairment losses are charged to the fair value for lasting impairments. If the fair value cannot be derived primarily from monitorable, contractable prices, the fair value is calculated using a discounted cash flow model using customary and generally accepted input parameters. Securities in the liquidity reserve are valued in accordance with the strict lower-of-cost-or-market principle. Accordingly write-downs to the lower fair value are to be made as at the balance sheet date.

Compared to the previous period there has been no change in the accounting policies described.

5.1.8.7 Quantitative Disclosures on Securitisations

In accordance with § 334 para. 2 no. 1 and of the German Solvency Regulation, the securitisation activities conducted with the NORD/LB Group as the originator and as the sponsor are shown in Tables 21 and 22. Receivable amounts are unweighted exposure values. It should be noted that the NORD/LB Group does not have any securitisation exposures in connection with revolving counterparty risk positions; therefore none are reported in accordance with § 334 para. 2 no. 4 of the German Solvency Regulation. The NORD/LB Group only has securitised receivables and securitisation exposures in the banking book.

The total of outstanding securitised receivables reported in Table 21 has increased due to repayments. The total for sponsor activities presented in Table 22 has risen due to the provision of new liquidity facilities.

The traditional securitisation of NORD/LB was terminated during the reporting period by way of the full repayment of the outstanding notes. NORD/LB originated no further traditional securitisation transactions.

Table 21: Total outstanding securitised receivables as originator

	Outstanding securitised receivables banking book	
(in € million)	31 Dec. 2013	31 Dec. 2012
True sale securitisations		
Receivables from wholly or part commercial real estate loans	–	121
Synthetic securitisations		
Receivables from housing construction loans	200	201
Receivables from wholly or part commercial real estate loans	699	898
Receivables from corporate loans	355	374
Total	**1 254**	**1 473**

Table 22: Total for sponsor activities

	Total for sponsor activities	
(in € million)	31 Dec. 2013	31 Dec. 2012
Receivables from other retail loans	36	–
Receivables from corporate loans	1 351	1 388
Receivables from own and purchase leasing receivables	265	153
Receivables from automobile financing (not including lease)	98	–
Total	**1 751**	**1 541**

The NORD/LB Group’s securitised receivables are neither non-performing nor in default, therefore no such receivables are reported in accordance with § 334 para. 4 of the German Solvency Regulation.

In accordance with § 334 para. 2 no. 2 and para. 3 no. 1 of the German Solvency Regulation, securitisation activities of the significant companies of the NORD/LB Group are not only shown in their function as originator, they are also shown in their function as an investor and sponsor in Tables 23 and 24. Compared to the previous reporting date the unweighted exposure values and equity requirements due to sale and repayments have fallen. The fall in the CRSA securitisation exposures is due to the transfer of retail from CRSA to IRBA. Due to new business in sponsor items the volume of off-balance-sheet items increased.

Table 24 shows that investments are primarily made in tranches with a low risk weight, whereby there has been a slight shift compared to the previous reporting date in the risk weight bands. This is in part due to the appreciations in value in the underlying pools.

Table 23: Total retained or purchased securitisation exposures

Types of receivables				Banking book
	Exposure values CRSA		Exposure values IRBA	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
On-balance-sheet items				
Receivables from housing construction loans	5	365	539	263
Receivables from other retail loans	–	46	20	–
Receivables from wholly or part commercial real estate loans	–	–	947	1 366
Receivables from corporate loans	–	–	520	537
Receivables from own and purchase leasing receivables	–	–	1	3
Receivables from automobile financing (not including lease)	–	23	5	–
Resecuritisations	–	–	–	31
Other on-balance-sheet items	–	–	125	149
On-balance-sheet receivables from special purpose entities and other on balance sheet loan enhancement measures	–	–	–	–
Total on-balance-sheet items	**5**	**434**	**2 157**	**2 349**
Off-balance-sheet items				
Liquidity facilities	–	153	1 751	1 388
Guarantees and other off-balance-sheet loan enhancement measures	–	–	–	–
Derivatives (eg. for hedging purposes)	–	–	–	–
Other off-balance-sheet items	–	–	–	–
Total off-balance-sheet items	**–**	**153**	**1 751**	**1 388**

Table 24: Capital requirements for retained or purchased securitisation exposures by risk weight band [1)]

	Banking book							
	Securitisations				Resecuritisations			
	Exposure		Capital requirement		Exposure		Capital requirement	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Standard approach	**5**	**586**	**0**	**28**	**–**	**–**	**–**	**–**
20 %	4	381	0	6	–	–	–	–
50 %	1	111	0	4	–	–	–	–
100 %	–	70	–	6	–	–	–	–
350 %	–	18	–	5	–	–	–	–
1250 %	–	6	–	6	–	–	–	–
Rating-based approach	**2 139**	**1 784**	**77**	**69**	**–**	**–**	**–**	**–**
≤ 10 %	789	484	5	3	–	–	–	–
> 10 % ≤ 20 %	635	515	8	7	–	–	–	–
> 20 % ≤ 50 %	366	319	8	7	–	–	–	–
> 50 % ≤ 100 %	234	346	12	18	–	–	–	–
> 100 % ≤ 250 %	50	56	4	5	–	–	–	–
> 250 % ≤ 650 %	37	56	13	20	–	–	–	–
> 650 % ≤ 1250 %	28	8	27	8	–	–	–	–
Regulatory formula approach	**1 199**	**1 399**	**23**	**10**	**–**	**31**	**–**	**0**
≤ 10 %	849	1 395	9	8	–	–	–	–
> 10 % ≤ 20 %	339	–	3	–	–	31	–	0
> 20 % ≤ 50 %	–	–	–	–	–	–	–	–
> 50 % ≤ 100 %	–	–	–	–	–	–	–	–
> 100 % ≤ 250 %	–	–	–	–	–	–	–	–
> 250 % ≤ 650 %	–	3	–	1	–	–	–	–
> 650 % ≤ 1250 %	10	0	10	0	–	–	–	–
Internal assessment approach	**464**	**387**	**6**	**13**	**–**	**–**	**–**	**–**
≤ 10 %	150	–	1	–	–	–	–	–
> 10 % ≤ 20 %	203	116	2	1	–	–	–	–
> 20 % ≤ 50 %	111	155	3	5	–	–	–	–
> 50 % ≤ 100 %	–	116	–	7	–	–	–	–
> 100 % ≤ 250 %	–	–	–	–	–	–	–	–
> 250 % ≤ 650 %	–	–	–	–	–	–	–	–
> 650 % ≤ 1250 %	–	–	–	–	–	–	–	–
Capital deduction	**–**	**11**	**–**	**11**	**–**	**–**	**–**	**–**
Look-through	**105**	**125**	**28**	**18**	**–**	**–**	**–**	**–**
Total	**3 913**	**4 292**	**134**	**148**	**–**	**31**	**–**	**0**

[1)] The reference date was adjusted retrospectively.

In Table 25 below the unweighted exposure values of the securitisation exposures, which are to be considered with a risk weight of 1,250 per cent or a capital deduction are broken down by type of receivables in accordance with the requirements of § 334 para. 2 no. 5 of the German Solvency Regulation. For securitisations the NORD/LB Group applies a risk weight of 1,250 per cent. The deterioration in the performance of the individual securitised pools and the subsequent downgrades by the external rating agencies resulted in an increase in securitisation exposures with the risk weight of 1,250 per cent.

Table 25: Securitisation exposures with a risk weight of 1,250 per cent

Securitisation exposures with a risk weight of 1,250 per cent (in € million)	Exposure value 31 Dec. 2013	Exposure value 31 Dec. 2012
Receivables from housing construction loans	9	9
Receivables from wholly or part commercial real estate loans	22	10
Other on-balance-sheet items	5	6
Total	**36**	**26**

In Tables 26 and 27 information is presented in accordance with the requirements of § 334 para. 2 no. 3 and para. 2 no. 6 of the German Solvency Regulation on the receivables securitised in the period under review and the NORD/LB Group's receivables planned for securitisation. The amounts reported are unweighted exposure values. In the period under review no institute-owned loans were securitised. The NORD/LB Group has not sold any receivables via traditional securitisation transactions and as a result not realised any profits or losses.

Table 26: Securitisation transactions in the reporting period

Types of receivables	Banking book			
	Securitisations		Profits/losses from the transactions	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Receivables from housing construction loans	–	215	–	–
Receivables from wholly or part commercial real estate loans	–	933	–	–
Receivables from corporate loans	–	382	–	–
Total	**–**	**1 530**	**–**	**–**

The receivables envisaged for securitisation have fallen sharply due to interest payments and repayments and were considerably increased by housing construction and commercial real estate loans.

Table 27: Total receivables envisaged for securitisation

(in € million)	Banking book 31 Dec. 2013	Banking book 31 Dec. 2012
Receivables from housing construction loans	127	–
Receivables from other retail loans	3	–
Receivables from wholly or part commercial real estate loans	4 483	3 399
Receivables from corporate loans	8 350	9 513
Other exposures	25	99
Total	**12 988**	**13 011**

In Table 28 purchased resecuritisation exposures are presented in accordance with the requirements of § 334 para. 3 no. 2 of the German Solvency Regulation. Investments by NORD/LB and Bremer Landesbank in resecuritisations was repaid in full in the second quarter of 2013.

Table 28: Resecuritisation exposures and hedged amounts

(in € million)	Banking book 31 Dec. 2013	Banking book 31 Dec. 2012
Resecuritisation exposures before security	–	31
Security by guarantees	–	–
of which guarantors with rating AAA to AA–	–	–
of which guarantors with rating A+ to A–	–	–
of which guarantors with rating BBB+ to BBB–	–	–
of which guarantors with rating less than BB+	–	–
Security by other collateral	–	–
Resecuritisation exposures after security	–	31

5.2 Investment Risk

5.2.1 Investment Risks Management

5.2.1.1 Investment Risks Management Strategies and Processes

Securing and improving the Bank's own market position is the primary motive behind the investment strategy of the NORD/LB Group. Generally investments serve to effectively consolidate the universal activities of the bank and to fulfil joint responsibilities resulting from the function as a state bank and a central bank for the savings banks. In order to support the NORD/LB Group's business model there is a deliberate focus on banks and financial companies.

The strategic objective of significant investments is to establish closer ties to support the customer-oriented business model of the NORD/LB Group. With all other investments, however, the general objective is to systematically reduce these where this makes sense from an economic and business point of view.

Group interests are maintained in relation to investments primarily by centrally specifying key business ratios or specific tasks. The aim is to ensure that the group is effectively managed and that transparency is guaranteed for third parties.

Investments are regularly monitored by analysing reports drawn up during the year, intermediate and annual reports and audit reports drawn up by the auditors. Control is carried out by NORD/LB representatives or the supervising subsidiaries in the supervisory boards, advisory boards, shareholders' meetings, annual general meetings and owners' meetings as well as by means of holding operative mandates in the companies.

Generally all investments are monitored centrally by NORD/LB's Investment Management. However, some subsidiaries, in particular Bremer Landesbank, have their own Investment Management Department.

The Erweiterter Konzernvorstand and the Konzernsteuerungskreise control all significant investments.

The method for measuring investment risk also consider risks beyond the carrying amount, e. g. additional contributions, profit/loss transfer agreements and letters of comfort. In the category of investment risks, the risk potential is quantified for different confidence levels and a time horizon of one year using a risk model; the parameters that are used generally focus on loss events relating to investments. The further calculation is based on the Gordy model, which is used by the Basel Bank Supervisory Committee for aligning equity requirements within the framework of Basel II.

The model used calculates contributions made by individual investments towards expected and unexpected loss at portfolio level, which together add up to the risk potential for the full portfolio.

At the level of the NORD/LB Group, all of the significant investments from a risk point of view are considered using the look-through approach and integrated into the risk management system of the group based on the quantified risk potential for each risk type.

5.2.1.2 Investment Risks Management Structure and Organisation

Risks resulting from investments at various levels in the group are managed by NORD/LB's Investment Management in close cooperation with other divisions, in particular the Finance and Risk Control Division and the Finance/Tax Division. Domestic and foreign investments are all supervised centrally by the Investment Management unit or by the corresponding units in the subsidiaries. Minor exposures are controlled and supervised by the divisions initiating the exposure in each case due to the close factual connection. This is done in close cooperation with Investment Management. The management of the investment-specific database is the responsibility of the Investment Data and Equity Management group, which also arranges most of the regulatory reports on investments.

The investment analysis developed by NORD/LB's Investment Management is an integral part of the measurement of investment risk and determine the significance of investments. Based on the analysis, which also expressly considers risks beyond the carrying amount, investments are classified consistently across all divisions as significant, important and other investments. The review considers both quantitative and qualitative criteria.

The result of the materiality analysis determines how closely the risks are monitored in all divisions of NORD/LB. A further differentiation is made from a risk point of view for the treatment of significant investments. The significant investments based on quantitative criteria of Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB (referred to as significant companies from a risk point of view in the disclosure report) are considered in the internal reporting of the NORD/LB Group at the level of individual risk type. The significant investments based on qualitative reasons of the NORD/LB Asset Management group and the Öffentliche Versicherungen Braunschweig group are reported together with the important and other investments as investment risk, but are subjected to closer analysis by the divisions included in Investment Management.

The concept will also be implemented in subsidiaries with their own investments (Bremer Landesbank, Deutsche Hypo and Öffentliche Versicherungen Braunschweig). The investments of the subsidiaries of NORD/LB Luxembourg are analysed by NORD/LB's Investment Management.

5.2.1.3 Investment Risks Cover and Mitigation

In order to enhance earnings potential and reduce capital tied and potential risk relating to participating interests the NORD/LB Group has, on the basis of a critical review of the investment portfolio, disposed of a range of participating interests since 2005. This strategy was continued in the year under review. A few smaller investments were also sold or liquidated in 2013.

5.2.1.4 Investment Risks Reporting

Investment Management reports to the Managing Board and the supervisory bodies of NORD/LB twice a year on the investment portfolio. The report includes among other things an analysis of current development and the strengths and weaknesses of the investments.

In addition, the significant and important investments are reported on quarterly in the Finance and Risk Control Division's Finance and Risk Compass. In addition to this, realised or anticipated income from investments is reported on a monthly basis to the Finance / Tax Division. The Finance and Risk Control Division also submits a report on the income and profitability of the NORD/LB Group's largest investments consolidated under commercial law to NORD/LB's Managing Board.

Information on the risk situation of the investments is considered on a quarterly basis in the Finance and Risk Compass by NORD/LB's Risk Control Division. Within this framework, Investment Management also reports on the profitability of the significant and important investments and on the risk situation on a portfolio basis.

In the significant subsidiaries from a risk point of view that have investments, corresponding reports are also regularly prepared on the respective investments.

5.2.2 Quantitative Disclosures on Investment Risk

In accordance with § 332 Nos. 2a and b of the German Solvency Regulation, Table 29 contains an overview of the carrying amounts of investment exposures in the banking book which are not consolidated for regulatory purposes and not deducted from equity. Such investments are currently not relevant for NORD/LB Luxembourg and NORD/LB CFB.

Since the reports required in accordance with the German Solvency Regulation are prepared on the basis of accounts prepared in accordance with the German Commercial Code in the NORD/LB Group by the reporting date, information is also provided here on valuations of investments in accordance with the German Commercial Code. For information on the accounting policies in accordance with IFRS the notes to the consolidated financial statements (Note 7) in the annual report are referred to. Participating interests are reported at acquisition cost or at the lower fair value in the case of permanent impairment, whereby the fair value is usually determined (unless in exceptional cases a listed price or current market value is known) from the present value of the future net earnings for the owners (income value) associated with the ownership of the company.

NORD/LB distinguishes in its materiality concept between three risk categories: material, important and other investments. The materiality thresholds are based on regulatory target ratios at group level. The carrying amounts of investment exposures are reported based on this materiality concept. As the aforementioned investment categories are monitored by Investment Management in Board Staff / Legal / Investments and the funds category is monitored by the respective market divisions, funds are reported separately.

For the sake of clarity, four investment groups are reported in Table 29, each broken down by listed and other investment exposures.

The following applies to the reporting in Table 29: when a listed value is ascertained, this is normally the fair value, for funds which are not listed the repurchase value is used. In cases in which a current value is ascertained for internal or external purposes, this is the fair value, otherwise the carrying amount is used. For investments measured using the equity method, the fair value in the disclosure reported is defined as the value of the proportionate equity.

Table 29: Carrying amounts of investment exposures [1)]

Groups of investment exposures (in € million)	Carrying amount		Fair value		Listed value	
	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
1. Material investments						
Listed	–	–	–	–	–	–
Other investment exposures	–	–	–	–		
2. Important investments						
Listed	–	–	–	–	–	–
Other investment exposures	26	26	108	109		
3. Other investments						
Listed	4	5	4	5	1	2
Other investment exposures	80	93	112	120		
4. Funds						
Listed	36	–	36	–	36	–
Other investment exposures	1 224	1 216	1 233	1 216	–	–

[1)] The reference date was adjusted retrospectively.

In accordance with § 332 Nos. 2c and d of the German Solvency Regulation, Table 30 contains an overview of the realised and unrealised profits or losses in the investment book which are not consolidated for regulatory purposes and not deducted from equity. Such investments are currently not relevant for NORD/LB CFB.

As in the previous period, in the current period a profit has been realised. There are also latent revaluation profits as at the reporting date.

Table 30: Realised and unrealised profits / losses from investment exposures[1)]

	Realised profit/loss from sale/liquidation (within the reporting period)		Latent/unrealised revaluation profits/losses (at the reporting date)					
			Total		Of which included in core capital		Of which included in supplementary capital	
(in € million)	2013	2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
Total	**5**	**3**	**123**	**173**	**–**	**–**	**–**	**–**

[1)] The reference date was adjusted retrospectively.

5.3 Market-Price Risk

5.3.1 Market-Price Risks Management

5.3.1.1 Market-Price Risks Management Strategies and Processes

The activities of the NORD/LB Group associated with market-price risks concentrate on selected markets, customers and product segments. The positioning on money, currency and capital markets should be in line with the significance and dimension of the group and is primarily geared towards the needs of customers and supporting the control measures of the bank as a whole. The NORD/LB Group does not take up any positions on an opportunistic basis.

Trading activities relating to customer business focus on interest products. Here the NORD/LB Group aims, within the scope of set market-price risk limits, to achieve earnings from term transformation or credit spreads and to participate in general market developments within the framework of these risk limits.

Credit investments in securities and credit derivatives result across the Group in significant credit spread risks in the banking book. The NORD/LB Group generally aims to use the credit spreads to maturity and to gradually reduce the amount of these credit investments by trimming down the portfolio.

Trading book positions are valued daily at current market prices. Valuation is carried out bank-wide at a specific time. Market prices and valuation parameters such as interest rate curves and spreads are reviewed daily by the Risk Control Department in the Finance and Risk Control Division which is independent of trading.

Gains/ losses are mainly determined in the front office systems. The valuation algorithms that are stored there have been approved by the Risk Control Department. Risk is ascertained in a risk control system supplied with market data from the front-office systems which is quality-assured independent of trading.

For the internal control and monitoring and limiting of market-price risks, Value-at-Risk (VaR) methods are generally employed for all significant portfolios.

The VaR figures are calculated daily using the historical simulation method. In the year under review the methodology and risk system in the NORD/LB Group were standardised. A unilateral confidence level of 95 per cent and a holding period of one trading day are used across the group. At the end of each quarter NORD/LB also prepares a VaR calculation for the NORD/LB Group based on the above parameters when calculating the risk-bearing capacity.

The VaR calculation is based on historical changes to risk factors over the previous twelve months. The models take account of correlation effects between risk factors and sub-portfolios. The calculation of credit spread risks in the banking book was also switched in the year under review to a VaR model across the group for operational control.

VaR models are particularly suitable for measuring market-price risks under normal conditions. The historical simulation method used is based on data relating to the past and is in this respect dependent on the reliability of the time series used. The VaR is calculated on the basis of the balances entered at the end of the day and does not therefore show any possible changes in items during the course of the day.

The prediction quality of the VaR model is verified with comprehensive backtesting analyses. This involves a comparison of the daily change in value of the respective portfolio with the VaR of the previous day. A backtesting exception exists if a negative change in value observed exceeds the VaR.

The validation of the VaR model shows an improvement in the number of backtesting exceptions in NORD/LB's banking book in the period under review, which was mainly attributable to technical improvements. The remaining exceptions result primarily from fundamental risks, i. e. differences in the scope of movements in the various swap curves within the same currency leading to higher daily fluctuations in the present value in the Treasury Division. Until the planned inclusion of these risks in the VaR model, a reserve item will be considered in the RBC model. The validation of the risk model in the NORD/LB CFB shows in addition that there is need for action regarding the risk assessment of bond options in the investment book. Until the presentation of these options in the VaR model has been corrected, a conservative add-on amount will be calculated and added to the VaR of NORD/LB CFB.

In addition to the VaR method, the effects of extreme market changes on the risk position of NORD/LB are examined in daily stress-test analyses. Various stress scenarios were defined for each of the types of market-price risk, namely interest rate, currency, share-price, fund-price and volatility risk, and these approximately reflect the average of the highest changes seen in the respective risk factors and are combined with scenarios spanning the types of market-price risk. The risk factors observed were selected in such a manner that material risks relating to the entire portfolio of NORD/LB and to the individual sub-portfolios of the trading divisions are covered.

In addition, other stress test analyses are conducted at least once a month, including strategy-related stress tests for selected trading items and specific stress scenarios for spread and basis risks in the banking book. Further general stress tests for all risk types are conducted on a quarterly basis within the context of reporting on risk-bearing capacity. The stress test parameters are reviewed on at least an annual basis and adjusted to changes in the market situation as and when required.

5.3.1.2 Market-Price Risks Management Structure and Organisation

The trading divisions Treasury, Markets and Bank Assets Allocation are responsible for controlling market-price risks in NORD/LB. Within the scope of their Global Head function, the trading divisions are also responsible for trading activities conducted at the foreign branches in London, New York, Singapore and Shanghai. Trade transactions are processed and controlled in separate divisions.

The strategic control of market-price risks is supported by the Asset Liability Committee (ALCO). The ALCO is an advisory body that generally meets on a monthly basis at the level of NORD/LB and on a quarterly basis at the level of the NORD/LB Group. It supports the strategic control of market-price risk positions, liquidity positions and the investment portfolio with the aim of optimising the profitability of the risk capital tied up in the positions. For this purpose recommendations for action are developed as a basis for decision-making for the Financial Markets Director. The members of NORD/LB's ALCO with voting rights are, in addition to the director responsible for Financial Markets, the Managing Director of the ALCO and the heads of the trading divisions. Representatives of the Finance and Risk Control Division, the Research / Economy Division, the Finance / Tax Division and the director responsible for the Finance and Risk Control Division also take part. The group's ALCO also includes the representatives of the significant companies from a risk point of view. The measures passed by the Managing Board are implemented by the Bank Assets Allocation and Treasury divisions and the relevant units of the subsidiaries.

Market-price risks are monitored in NORD/LB by the Risk Control Department in the Finance and Risk Control Division, which in accordance with MaRisk operates independently of divisions responsible for market-price risk control in terms of both function and organisation and performs comprehensive monitoring, limiting and reporting activities for NORD/LB (including its foreign branches) and the NORD/LB Group. This also includes calculating amounts eligible based on the internal risk model for the quarterly SolvV report. The responsibility for the development and validation of the risk model also lies with the Risk Control Department.

The market-price risks of Bremer Landesbank, the sub-group NORD/LB Luxembourg and Deutsche Hypo are managed decentrally by the local trade and Treasury divisions. For the monitoring of risks, these companies have their own Risk Control units. The data is integrated into the reporting at group level.

5.3.1.3 Market-Price Risks Cover and Mitigation

The VaR limit for market-price risks is derived from the RBC model, allocated by Managing Board resolution to the Director who is responsible for Financial Markets and who delegates to the subordinate organisational units.

Compliance with the limits is monitored by the Risk Control units. Any losses are immediately added to the loss limits, hence resulting in a reduction in VaR limits in accordance with the principle of self-absorption. Correlation effects between the portfolios are included in calculating VaR and in the delegation of sub-limits.

5.3.1.4 Market-Price Risks Reporting

In compliance with the MaRisk Management, the Risk Control Department, which is independent of the divisions responsible for the positions, reports daily on market-price risks to the respective Director. In addition to this, the market-price risks under a gone concern scenario, which also include the credit spread risks in the banking book, are reported on at least a monthly basis. The Managing Board is informed in detail once a month about NORD/LB's and the NORD/LB Group's market-price risks and earnings position of the trading divisions.

Daily reporting to the responsible directors and monthly reporting to the Managing Board also take place in the significant subsidiaries from a risk point of view.

5.3.2 Quantitative Disclosures relating to Market-Price Risk

In accordance with § 330 of the German Solvency Regulation, for institutes with internal models first of all an overview of the VaR values of the relevant market-price risk exposures in the trading book and banking book is to be reported, and secondly, in accordance with § 318 para. 1 clause 2 of the German Solvency Regulation the daily VaR is to be compared with the daily changes in the value of the portfolio and significant VaR transgressions are to be disclosed.

VaR data relating to general interest-rate risks and general and specific share-price risks and currency risk in the trading and banking book determined in the internal model are shown in Table 31.

The schedule contains the VaR on the balance sheet date, the highest and lowest VaR during the reporting period and the annual average.

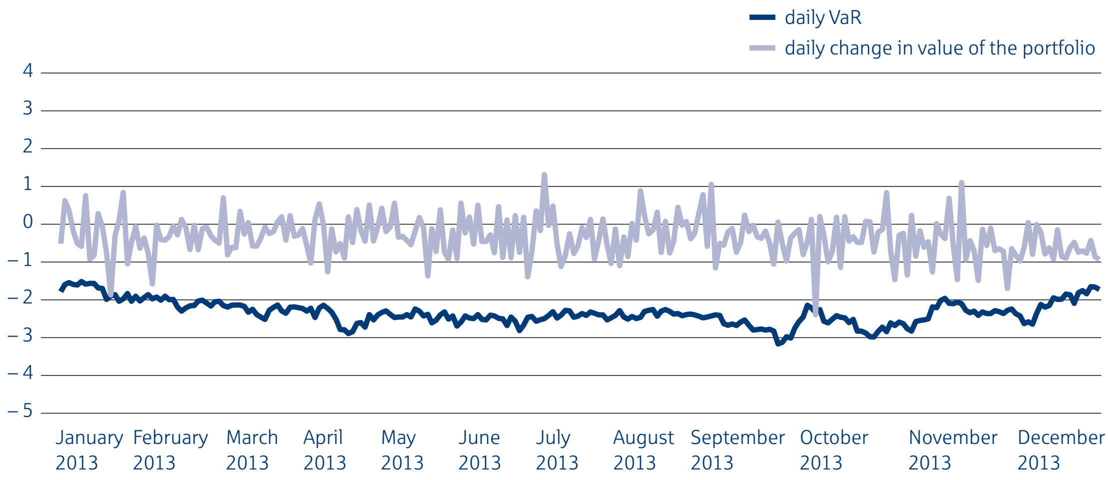
The VaR for Table 31 has been calculated with a confidence level of 99 per cent and a holding period of one trading day.

Table 31: Overview of the VaR of portfolios in the trading book and currency risk in the banking book (internal model)

	VaR (at the reporting date)		VaR values (during the reporting period)					
			Highest value		Lowest value		Reporting periods Ø	
(in € million)	31 Dec. 2013	31 Dec. 2012	2013	2012	2013	2012	2013	2012
Combined VaR	**2**	**2**	**3**	**4**	**1**	**2**	**2**	**3**
General interest-rate risk	1	1	2	4	1	1	1	2
Share-price risk	0	0	0	0	0	0	0	0
Volatility risk	1	1	2	1	0	0	1	1
Currency risk	1	1	1	1	1	1	1	1
Stressed VaR	**8**	**5**	**8**	**10**	**4**	**4**	**5**	**6**
General interest-rate risk	4	4	6	7	3	3	4	4
Share-price risk	2	1	2	1	1	1	1	1
Volatility risk	2	1	3	2	1	0	2	1
Currency risk	3	1	3	2	1	1	1	1

The following diagram shows the VaR values of the categories in Table 31 calculated daily at the close of business using the internal model with a confidence level of 99 per cent and a holding period of one trading day. In order to make it easier to identify any backtesting exceptions, i. e. negative changes in value in accordance with § 318 para. 1 clause 2 of the Germany German Solvency Regulation which exceed the previous day's VaR value, the following presentation was chosen: The VaR value is reported as a potential loss with a minus sign, and the change in value in accordance with § 318 para. 1 clause 2 of the German Solvency Regulation at the close of business on this date and the VaR value at the close of business of the previous day are assigned to the respective date. This is not the backtesting of the VaR value for internal control purposes, but the relevant value in terms of regulatory requirements.

VALUE-AT-RISK (99 PER CENT, 1 DAY) AND PORTFOLIO CHANGE IN VALUE (in € million)



The only blip in 2013 was primarily due to market changes brought about by a meeting of the Federal Open Market Committee of the Federal Reserve on 18 September 2013, in which it surprisingly decided not to reduce its bond-buying programme (Quantitative Easing 3). This resulted in new all-time highs for the DAX and Dow Jones and a massive fall in the USD (up to – 20 bps) and EUR swap rates (up to – 8 bps). In addition, in particular the USD and JPY fell against the EUR by around 2 per cent.

Reference is made to Table 3 in Section 4.2.2 on capital requirements for disclosures on the capital requirement for market-price risks, presented separately for the standard approach and the internal model approach.

5.3.3 Special Disclosures on Interest-Rate Risk in the Banking Book

Interest-rate risks in the banking book mainly arise from new business or strategic interest management. In order to quantify the risk content of these positions at individual institute level on a daily basis, the VaR model, which is also used for the trading book, is applied. The quarterly calculation of the interest rate shock in the banking book is based on the regulatory stress test involving a parallel shift in the interest rate curve by + 200 basis points or – 200 basis points. In accordance with the BaFin Circular 11/2011 (BA), a shorter interval between these internal calculations was set as appropriate in each individual institute.

The models used in daily control measures are also used for interest rate shocks. This involves mapping onto the fixed interest period for products with fixed terms and various models of stochastic products. The majority of open-end investments are shown in moving average models. Unsecured cancellation rights for loans are restricted by imposing limits. Unlimited equity and unlimited investments are not considered in accordance with regulatory requirements.

Table 32 shows in accordance with § 333 para. 2 of the German Solvency Regulation changes in the present values given an interest rate shock of + 200 basis points and an interest rate shock of – 200 basis points. Increases in present values are shown as positive figures while decreases in present values are preceded by a minus sign.

In accordance with Federal Financial Supervisory Authority (BaFin) Circular 11/2011, the same procedure is used to calculate the change in the present value of every foreign currency as the procedure for positions in euros. For foreign currencies the least favourable changes in present values are added up and this total is then added to the change in the present value in the respective euro scenario.

Table 32: Interest-rate risks in the banking book

	Change in present value Interest-rate shock + 200 basis points		Change in present value Interest-rate shock – 200 basis points	
(in € million)	31 Dec. 2013	31 Dec. 2012	31 Dec. 2013	31 Dec. 2012
EUR	– 588	– 625	444	403
Others	– 164	– 105	– 164	– 105
Total	**– 752**	**– 730**	**280**	**298**

5.4 Liquidity Risk

5.4.1 Liquidity Risks Management

5.4.1.1 Liquidity Risks Management Strategies and Processes

Securing perpetual liquidity for the NORD/LB Group is strategically essential. While traditional liquidity risk is principally hedged by maintaining a sufficient supply of liquid assets (in particular central bank eligible securities), refinancing risks are allowed to be taken with a structural transformation of liquidity terms. Risks are constrained with suitable limits in both cases.

The limit for traditional liquidity risk serves to secure the ability to make payment even in a conservative stress scenario, while the limit for the refinancing risk is derived from the risk strategy and the risk-bearing capacity of the NORD/LB Group and allows term transformation to contribute to earnings.

In order to limit market-liquidity risks the NORD/LB Group primarily makes securities transactions in markets which have proven themselves to be sufficiently liquid even when they are under pressure.

In the Global Group Liquidity Policy the business policies for liquidity risk management in the NORD/LB Group are specified. The individual institutes of the NORD/LB Group also have liquidity control policies which describe the basic strategic guidelines for ensuring a sufficient supply of liquidity. Liquidity management measures in cases of emergency and in crisis situations are specified in contingency plans.

Risk concentrations on the liabilities side are prevented by a diversified investor base and product range. The focus is on institutional and public investors, which is in line with the risk-based orientation of the NORD/LB Group. The diversification of refinancing sources is also strengthened by Pfandbrief issues and retail deposits.

The NORD/LB Group calculates the utilisation of volume structure limits for the various maturity bands on the basis of a liquidity maturity balance sheet for the entire item, which essentially reflects the standard case. Liquidity risk is quantified in a risk-bearing capacity concept resulting from a present-value consideration of the refinancing risk.

Calculation of dynamic and static stress scenarios for modelling traditional liquidity risk is based on current liquidity progress reviews. These are stressed until they reflect a crisis. For example, a reduced amount of accounting liquidity and an increased utilisation of credit commitments is presumed. The stress scenarios can be used to show the effect of unexpected events on the liquidity situation of the group, enabling it to plan for the future and to be well-prepared for cases of emergency.

The analysis of stress scenarios takes into consideration the overriding significance of the market liquidity of all of the securities in the portfolio. In addition, the credit spread risks for all securities are considered when calculating market-price risks. Since the spreads observed on the market reflect both the credit rating of an issuer and the market liquidity of the securities, the risk report also indirectly takes into account the market liquidity of the securities. No separate risk dimension is applied for market liquidity risks.

5.4.1.2 Liquidity Risks Management Structure and Organisation

In addition to the Treasury Division, the global trading divisions Markets and Bank-Assets Allocation and the Finance and Risk Control Division are included in the process of liquidity risk management at NORD/LB.

Treasury is responsible controlling items bearing liquidity risks and producing profits and losses resulting from changes in the liquidity situation (in general or specific to NORD/LB).

The Treasury Division also presents the liquidity maturity balance sheet to the Asset Liability Committee. It also reports to this committee on refinancing risk and makes recommendations for action concerning the future approach towards strategic planning if necessary.

The Risk Control Department of the Finance and Risk Control Division is responsible for the implementation and development of internal procedures for measuring, limiting and monitoring liquidity risks. The Risk Control Department also ascertains and monitors traditional liquidity risk and monitors refinancing risk. The Finance and Risk Control Division also ascertains and monitors regulatory indicators in accordance with the German Liquidity Regulation (Liquiditätsverordnung, LiqV).

A Global Liquidity Management crisis team is available in the event of a liquidity crisis and assumes responsibility for liquidity management in close cooperation with the Managing Board.

The liquidity risks of Bremer Landesbank, the Luxembourg sub-group and Deutsche Hypo are managed decentrally by the local Treasury units and monitored by their own Risk Control units. In order to coordinate the decentralised units of the NORD/LB Group, information is regularly exchanged between the significant group companies from a risk point of view to address both issues relevant to control in the Treasury Division and also model-relevant issues in the Risk Control Division.

5.4.1.3 Liquidity Risks Cover and Mitigation

The refinancing risk of NORD/LB and the significant subsidiaries from a risk point of view is limited by the present value limits and the volume structure limits for various maturity bands that are derived from the risk-bearing capacity. The liquidity progress is also considered by currency.

Traditional liquidity risk is primarily limited by analysing a dynamic stress scenario. The scenario describes the most likely crisis situation in each case, as at the reporting date describing a market environment which is characterised by economic problems in the periphery countries as well as the risk of high loan losses, particularly in the area of ship financing. Analysis is based on liquidity cash flows and covers the coming twelve months on a daily basis. For products without fixed liquidity flows, optional components (e. g. from irrevocable credit commitments), planned new business and refinancing opportunities, assumptions are made in accordance with the market situation which are subject to regular validation.

With the help of the limit system it is ensured that in the event of a stress case, surplus liquidity is available for at least three months. This means that securing the ability to make payment at any time in this maturity band is given preference over possible opportunities to generate profits. The aim is to ensure a liquidity surplus for at least six months in the dynamic stress scenario taking into account profitability aspects.

The dynamic stress scenario is supplemented by other statistical stress tests. These tests cover a scenario specific to NORD/LB and also the alternative scenario of a comprehensive liquidity crisis as well as a short-term scenario for a market-wide liquidity problem.

Market liquidity risks are implicitly accounted for by means of classifying securities in the liquidity maturity balance sheet in accordance with their market liquidity. Securities are allocated on the basis of a detailed security category concept to one of eleven main categories with one to eight subcategories (e. g. by central bank eligibility and rating). The liquidity maturity balance sheet is presented by liquidity category, with the maturities ranging from due on demand to final maturity.

When classifying the securities in the liquidity categories, in addition to the tradability, in particular the usability of the collateral of key importance, i. e. the suitability of the securities as collateral in repo transactions, with central banks or as cover for Pfandbriefe.

For control at group level, a Group liquidity maturity balance sheet is prepared. For this purpose all of the cash flows in euro and the translated foreign currency cash flows of the significant group companies from a risk point of view are compiled in one overview. The liquidity maturity balance sheets are also prepared in the most important foreign currencies.

5.4.1.4 Liquidity Risks Reporting

The Risk Control Department provides the responsible divisional heads every day with the data on the dynamic stress test scenarios for the NORD/LB Group's traditional liquidity risk.

In addition to this the NORD/LB's biggest investors in new business are monitored regularly. The responsible divisional and departmental heads are informed of liquidity concentrations in the concentration risk report.

In 2013 the Managing Board was informed in detail in the monthly report on market and liquidity risks of the NORD/LB Group's liquidity risk situation. Information is also provided on a quarterly basis in NORD/LB's Finance and Risk Compass.

The monthly refinancing risk reports are prepared in euro and in the most important foreign currencies. The maturity balance sheets upon which the refinancing risk is based are also presented together with the stress tests to the Asset Liability Committee which meets on a monthly basis.

The liquidity ratios calculated in accordance with the German Liquidity Regulation can be calculated daily and submitted to the Treasury Division for the purpose of regulating liquidity risk. The report in accordance with the German Liquidity Regulation for the entire bank and each location is submitted to the Bundesbank, the control divisions and to the Managing Board of NORD/LB once a month.

With the significant subsidiaries from a risk point of view, the relevant reports on traditional liquidity risk, refinancing risk and the liquidity situation are established in the status quo and under stress. These inform the controlling divisions, responsible directors and the Managing Board on a monthly, weekly or even daily basis.

5.4.2 Quantitative Disclosures on Liquidity Risk

There are no quantitative regulatory requirements relating to the disclosure of liquidity risk. Reference is made to the Forecast, Risk and Opportunities report included in the Management Report of the NORD/LB Group.

5.5 Operational Risk

5.5.1 Operational Risks Management

5.5.1.1 Operational Risks Management Strategies and Processes

Operational risks are imminent in any business activity. For this reason, various measures undertaken in the NORD/LB Group have for a long time now focussed on the management of operational risks.

The NORD/LB Group pursues the goal of efficient and sustainable management of operational risks, i. e. avoidance or transfer where this makes economic sense. Countermeasures are taken when necessary if the costs for the protection are not greater than the costs directly incurred as a result of the risk or if its reputation could be significantly affected. The relevant legal requirements must be met at all times.

Operational risks are considered in all business decisions. Future losses are countered by rules and the internal control systems as well as by a strong risk culture. The raising of risk awareness among all employees and an open approach plays a key role in avoiding operational risks. Business continuation and contingency plans serve to limit damage in the case of extreme unexpected events. Very extreme, unforeseeable events are countered by a crisis management organisation. Insurance is taken out to actively protect against any remaining risks.

The management of operational risks is performed largely on a decentralised basis and is supported by a central methodical framework for risk identification and assessment. Numerous sources of information such as loss events, risk indicators and scenarios are evaluated continually in order to ensure that the bank's view of the risk situation is always up to date. Appropriate countermeasures are taken by the responsible divisions as and when required. The appropriateness and effectiveness of the internal control system, the business continuation and contingency planning and the appropriateness of the insurance cover are reviewed at regular intervals.

The NORD/LB Group collects data on losses from operational risks in a loss event data base; there is a minimum limit of € 1,000. Data in the loss event data base provides the basis for analyses in support of risk management and is an important element of the statistical/mathematical risk model developed by the bank. The significant group companies from a risk point of view and the NORD/LB Asset Management group are included in the collection of loss events.

The loss events collected are exchanged in anonymous form in the Data Consortium of Operational Risks (DakOR) with other banks. The consortium data is added to the data which is used for the internal model. In addition information contained in the ÖffSchOR database is available in which press reports on major losses resulting from operational risk are collected, structured and processed. The two sources of data are used for scenario analyses and for regular benchmarking.

With the help of the risk assessment method applied in NORD/LB, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo, NORD/LB CFB and the NORD/LB Asset Management group, the recording of data concerning past loss events is supplemented with future components. Expert appraisals on the impact of specific scenarios provide a detailed insight into the risk situation of the individual bank divisions so that relevant measures can be derived if necessary. The scenarios and areas where data is gathered are selected on a risk-oriented basis and on the basis of an analysis of various data sources (e. g. loss events and audit reports). The results are included in the internal model and as a result improve the measurement accuracy.

In order to identify potential risks early on and to take countermeasures, risk indicators are used in NORD/LB. The selection of indicators takes place on a risk-oriented basis and is regularly reviewed for its appropriateness. Causes of risk should also be identified and concentrations of risk prevented with the continual and comparative analysis of loss events, risk indicators and scenarios.

The NORD/LB Group has an internal model to measure operational risks. For this purpose a loss distribution approach is used in which elements of the extreme value theory are considered. The distribution parameters are calculated based on internal data, scenario analyses and external data from the DakOR consortium. Correlation effects are modelled with the help of a Gaussian copula. Risk indicators in the warning area impact on the models. The VaR calculated by the model is used as a control variable for operational risks in the RBC model.

If anticipated losses are considered in the planning process of the divisions, these are deducted from the model result. An allocation process which combines size indicators with risk-sensitive elements is used to distribute the model results to the individual institutes. The models parameters are regularly subjected to a comprehensive validation and stress tests. Mitigation effects due to insurance or other instruments used to transfer risk are currently not considered in the quantification model. The NORD/LB Group considers the use of customary insurance products to be part of active risk control.

The methods and procedures implemented in the NORD/LB Group meet the requirements of § 272 of the German Solvency Regulation concerning the use of the standard approach for operational risk. The amount allowable for operational risk was calculated in the year under review using this approach. The methods used in overall bank management and to establish the risk-bearing capacity largely meet the requirements of the German Solvency Regulation for an advanced measurement approach.

5.5.1.2 Operational Risks Management Structure and Organisation

All hierarchical levels and divisions are involved in the management of operational risks. The Managing Board stipulates the basic method of handling operational risk, taking into account the risk situation at overall bank level. Responsibility for the control of operational risk within the general environment specified is decentralised and lies with the individual divisions.

NORD/LB has a security strategy and uniform standards in order to efficiently and sustainably protect the bank from harm and at the same time meet legal and supervisory requirements. Contingency measures ensure appropriate operation in the event of an emergency and a return to normal operations as quickly as possible with interlinked business continuation and recovery planning which focuses on time-critical activities and processes. The higher-level contingency and crisis organisation ensures communication and decision-making capability in the event of escalating emergencies and crises.

The Finance and Risk Control Division is responsible as the central point the independent monitoring and reporting of operational risks. It is also responsible for specifying the rules for developing and implementing the instruments provided by the division across the Group to control operational risks. The strategic and conceptual responsibilities relating to security, contingency and crisis management are combined in the Group Security Division. The Compliance Department is organised as a department that is independent from the other divisions. It ensures in a process-integrated manner that the Group has appropriate policies and methods so that the requirements of the German Securities Trading Act can be met and money laundering, the financing of terrorism or any other criminal acts can be prevented. Internal Audit is responsible for the process-independent audit to establish whether methods and procedures are properly implemented and carried out.

The operational risks of Bremer Landesbank, the sub-group NORD/LB Luxembourg and Deutsche Hypo are managed decentrally. For the monitoring of risks, these companies have their own Risk Control units which coordinate closely with the Risk Control Division of NORD/LB. The methods and guidelines which apply throughout the Group are defined by the Finance Risk Control Division of NORD/LB.

5.5.1.3 Operational Risks Cover and Mitigation

The NORD/LB Group possesses a suitable framework in the form of technical and organisational measures, contractual provisions and rules laid out in writing to prevent operational risks from occurring in its processes as far as possible. With control and monitoring measures the group ensures it complies with the relevant regulations and standards. If weaknesses in the organisation or in the control system are identified, appropriate countermeasures are taken immediately. It is the declared group-wide objective to give greater consideration to processes across the visions and in so doing reveal weaknesses in the control system and rectify any resulting damage at an early stage.

The internal control system (ICS) has a uniform structure in the NORD/LB Group. The ICS framework implemented for this purpose is based on the framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) for internal controls and includes a specific operational and organisational structure. With the use of standardised methods and procedures, an appropriate and effective ICS will be ensured throughout the bank and a lasting improvement sought.

The operational structure of NORD/LBs ICS is geared towards a recurrent control cycle. The overriding goal is the bank-wide assessment of the ICS based on the consideration of the appropriateness and effectiveness of the controls implemented. The control cycle will be supported by an organisational structure optimised for this purpose. This includes roles related specifically to the ICS, the tasks, competencies and responsibilities of which are defined and distinguished from one another. The current reporting to different groups of recipients is part of this control cycle.

Based on a standard process map in the NORD/LB Group, the risk content of processes is assessed with the help of a scoring model and a detailed analysis with regard to the appropriateness and effectiveness of the ICS is undertaken.

Within the scope of a defined security process, NORD/LB actively controls its security risks. Deviations from the security standard and improvements required as a result of emergency and crisis exercises and the resulting measures documented, assessed and monitored fully. External threats are also monitored regularly. The risks documented in the security process are routinely included in the comprehensive reporting of operational risks. In the IT Division, instructions on procedures, alternative capacities and backups ensure that the IT infrastructure is adequately stable. Security concepts and contingency plans supplement pre-emptive measures in order to prevent loss or damage resulting from the failure or the manipulation of systems and information. The concepts are regularly tested and updated. In order to prevent the risk of NORD/LB’s internal computer centre failing, a second computer centre exists in a separate location.

Staff risk is countered by an appropriate level of staff in terms of quality and quantity. In order to ensure that there is an appropriate level of staff, the NORD/LB Group pays particular attention to training and further education as well as its target number of employees. The aim is to ensure that all employees have the required skills so that they can perform their tasks properly and efficiently.

Staff shortages are included in the contingency planning. Staff-related risks are reduced by a range of measures. The requirements of the Institute Remuneration Act (Institutsvergütungsverordnung) are met in the NORD/LB Group. The remuneration report can be found at https://www.nordlb.com/investor-relations/reports/.

A balance between work and family life is supported by a family-friendly personnel policy which should encourage staff to remain with the NORD/LB Group long term. Ensuring that staff stay healthy is a top priority, because it is only with healthy and capable staff that the bank can continue to provide its customers with high-quality services in the long term. Besides offering a wide range of personal preventive health measures, the bank’s health management focuses on providing working conditions that promote health, as required with the involvement of management.

In order to prevent criminal acts, money laundering, the financing of terrorism and other risks to compliance, the Group has established comprehensive protection and prevention measures. These are verified continually by a range of control and monitoring activities and developed continually on the basis of institute-specific risk analyses. If significant shortcomings should be revealed, corrective measures will be taken and their implementation tracked.

If there are any indications of major fraud, the further course of action is decided in an ad-hoc committee at management level. Employee awareness of risks is raised with classroom and online-based training, a regular newsletter and ad-hoc information on current risks. There is a whistleblowing system for employees and customers so that information can be passed on securely.

In order to safeguard against legal risks, the respective Legal Department is to be consulted for example when legal action to be taken and when contracts which are not based on approved standard contracts are concluded. In order to ensure that new banking regulatory requirements are implemented correctly, the Compliance Department provides evidence across all divisions and informs the divisions concerned of the requirements for action as a result of the new regulations.

The quality of external suppliers and service companies is ensured in the NORD/LB Group by concluding service level agreements or detailed specifications and the ongoing controlling of performance. A process for assessing service providers in terms of their significance in terms of risk was installed in order to meet the Minimum Requirements for Risk Management concerning outsourcing. For each significant service outsourced a position is nominated which is responsible for managing services and risk relating to the business relationship. A risk assessment takes place on a quarterly basis using the method of risk indicators. An individual contingency plan is also drawn up for each significant service outsourced.

The NORD/LB Group's insurance cover is adequate. NORD/LB's insurance cover is analysed regularly with regard to its scope and effectiveness. Natural disasters and terrorist attacks are defined as force majeure and are countered by appropriate contingency concepts.

5.5.1.4 Operational Risks Reporting

Within the framework of a continuous risk management process, results from the collection of loss events, risk assessment, risk indicators and internal model are analysed and communicated to the Managing Board on a quarterly basis (via the Finance and Risk Compass) and the responsible divisions as and when required and at least once a year.

5.5.2 Quantitative Disclosures on Operational Risks

Reference is made to Table 3 in Section 4.2.2 on capital requirements for disclosures on minimum capital requirements for operational risks.

LIST OF TABLES

The tables are based on the use cases of the expert panel on disclosure requirements of the Deutsche Bundesbank of November 2006.

LIST OF ABBREVIATIONS

AAKA	Allgemeiner Arbeits- und Kreditausschuss (General Working and Credit Committee at NORD/LB)
ABCP	Asset-Backed Commercial Papers
ABS	Asset-Backed Securities
ALCO	Asset Liability Committee
AT	General part
BA	Banking supervision
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority)
CCF	Credit Conversion Factor
COSO	Committee of Sponsoring Organisations of the Treadway Commission (author of a standard for internal controls)
CPC	Credit-Pricing Calculator
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSSF	Commission de Surveillance du Secteur Financier (Luxembourg's financial supervision authority)
DakOR	Datenkonsortium zur Sammlung von Schadenfällen im Kontext der operationellen Risiken (Data Consortium for the collection of loss events in the context of Operational Risk)
DK	Deutsche Kreditwirtschaft (German Banking Industry Committee)
DSGV	Deutscher Sparkassen- und Giroverband (German Association of Savings Banks and Girobanks)
EAD	Exposure at Default
EBA	European Banking Authority
EL	Expected Loss
EU	European Union
SVA	Specific valuation allowance
GRC	Group Risk Committee
GSS	Global Securitization Services
HGB	Handelsgesetzbuch (German Commercial Code)
IAA	Internal Assessment Approach
ICAAP	Internal Capital Adequacy Assessment Process
IFD	Initiative Finanzstandort Germany (Initiative for Germany as a Financial Location)
IFRS	International Financial Reporting Standards
ICS	Internal Control System
IRBA	Internal Ratings Based Approach
CRM	Credit Risk Management
CRSA	Credit Risk Standard Approach
KSK	Konzernsteuerungskreis (Group Control Committee)
KWG	German Banking Act (Gesetz über das Kreditwesen)
LAPA	Liquidity Asset Purchase Agreement
LGD	Loss Given Default
LiqV	"Liquiditätsverordnung" (German Liquidity Regulation)
Lux GAAP	Luxemburg Generally Accepted Accounting Principles National Accounting Regulations of the Grand Duchy of Luxembourg
MaRisk	"Mindestanforderungen an das Risikomanagement" (Minimum Requirements for Risk Management)
MSK	Market fluctuation concept
NORD/LB	Norddeutsche Landesbank Girozentrale, Hanover
NPP	New-Product Process
OECD	Organisation for Economic Cooperation and Development
ÖffSchOR	Datenbank Öffentliche Schadenfälle OpRisk (database of public loss events relating to operational risk)
PD	Probability of Default
pEWB	Lumpsum specific valuation allowances
PoWB	General loan loss provisions
PWB	Lumpsum loan loss provisions
RBA	Rating Based Approach
Repo	Repurchase Agreement
RSU	Rating Service Unit GmbH & Co. KG
RTF	Risk-Bearing Capacity
RW	Risk Weight
RWA	Risk-Weighted Assets
SFA	Supervisory Formula Approach
SKM	Special Credit Management
SolvV	"Solvabilitätsverordnung" (German Solvency Regulation)
SR	Sparkassen Rating und Risikosysteme GmbH
VaR	Value-at-Risk
VÖB	"Bundesverband Öffentlicher Banken Deutschlands" (German Federal Association of Public-Sector Banks)

Die norddeutsche Art.

NORD/LB
Norddeutsche Landesbank Girozentrale

Friedrichswall 10
30159 Hanover

Phone: +49 (0) 511/361-0
Fax: +49 (0) 511/361-2502
www.nordlb.com
www.facebook.com/nordlb
www.twitter.com/nord_lb

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